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11/15/82

Financial Markets

Irving Trust

Irving Trust Company
One Wall Street
New York, NY 10015

Economic Research &
Planning Division

Friday
(Noon)

Nov. 12, 1982

"Waiting for the Robert E. Lee" was once a major pastime along the banks of the Mississippi, an activity with parallels in today's financial markets. The theme used to be "Waiting for the Money Supply," but that has lost ground with the Fed's de-emphasis of the weekly money numbers, and Fridays are no longer what they were. Instead, a new favorite has emerged--"Waiting for the Discount Rate Cut"--and guesses on the timing of that cut are a central current market preoccupation.

That about sums up activity over the past two weeks--short-term rates moved up and down, but showed very little net change, with a discount rate cut the necessary (and generally expected) trigger for the next movement in rates. Fed funds gave no directional impetus, holding steady in a 9.2%-9.5% range (except on Wednesday), while 90-day CDs traded in an 8.9%-9.2% range at a relatively narrow (100 basis points) spread over 91-day bills. No prime rate cuts, no big shifts in commercial paper rates, not really much of anything--it all hangs on the discount rate cut.

Long-term markets were marginally more positive--the new 30-year Treasury bond was well received, and long-term rates edged down in most markets. Here too, however, the discount rate cut is key, since long-term markets are priced at relatively high levels vs. financing costs. This means that if financing costs do not drop (a discount rate cut would presumably push down Fed funds and RPs, at least at first), current price levels in long-term debt markets would look a bit vulnerable. That has inhibited enthusiasm in long markets, limiting price gains.

So when will the discount rate be cut? Hopes for a postelection move were not fulfilled, and expectations of action today have shifted to Monday, November 15, when October M2 data will be released. With M2 growth estimated to have dropped to a 6% annualized rate, that could be a suitable occasion for a discount rate cut. Another possibility is after the Federal Open Market Committee meeting on Tuesday, November 16, with action generally expected by next Friday at the latest.

Note that the question is when, not if, the discount rate will drop. Most market watchers are convinced that the rate will be cut at least once and very possibly twice before year-end. This conviction stems from the combination of a very weak economy and a declining inflation rate--in these circumstances, the argument goes, the Fed's course is clear and has been clearly indicated by policy moves since last July. If the discount rate is not cut next week, that conviction could begin to waver, putting downward pressure on current price levels.

A final note--the thin spread on CDs over bills (100 basis points vs. 300 last August) is interesting, given continuing international debt problems. The lack of response to talk about a Brazilian approach to the IMF points to a substantial lessening in worry about banks. One reason may be the fact that debt problems have not been making headlines; another may be the significant shifts in U.S. (and other) government policy on international debt, with IMF support now high on the agenda. Debt problems may well be more publicized over the next month or two, which could test the markets' current calm assessment of credit risks.

Anne Parker Mills

Irving Trust

Market Yields

	11/12/82 (Noon)	Week Ago	Year Ago
Prime Lending Rate at Irving Trust Company	12.00%	12.00%	17.00%
Effective since	10/13/82		
Discount Rate at Federal Reserve Bank	9.50	9.50	13.00
Federal Funds	9.50	9.25	13.13
Repurchase Agreements	9.13	9.25	12.50
U.S. Treasury Issues			
Bills			
3 months	8.48	8.01	11.30
6 months	8.92	8.70	12.21
1 year	9.15	8.99	12.34
Coupons			
2 years	9.81	9.71	12.85
4 years	10.29	10.20	13.24
7 years	10.58	10.48	13.40
10 years	10.54	10.47	13.20
Long Bond	10.42	10.69	13.27
Negotiable Certificates of Deposit-Secondary Market			
1 month	8.95	8.85	12.60
3 months	9.10	8.95	12.55
6 months	9.30	9.10	12.80
1 year	9.75	9.50	13.00
Banker's Acceptances			
1 month	8.85	8.70	12.65
3 months	8.90	8.90	12.50
6 months	8.95	9.05	12.65
Eurodollar Deposits			
1 month	9.63	9.38	13.00
2 months	9.75	9.50	13.13
3 months	9.88	9.75	13.25
Commercial Paper - Prime Names			
Directly placed by:			
Finance Companies			
1 week	8.75	8.63	12.75
1 month	8.75	8.63	12.50
3 months	8.50	8.50	12.38
Bank Holding Companies			
1 month	7.75	8.50	12.00
Dealer Placed:			
3 months	8.13	8.38	12.45
New AA Corporate Utility Bond	11.90	12.00	16.10
Tax Exempt			
6 month Project Notes	4.00	4.30	6.50
1 year AAA Bond	5.50	5.50	7.90
5 year AAA Bond	7.00	7.00	8.50
20 year AAA Bond	9.40	9.30	11.60

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Financial Markets

Irving Trust

Irving Trust Company
One Wall Street
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Economic Research &
Planning Division

Friday
(Noon)

Nov. 19, 1982

Another week, another wait, and still no cut in the discount rate--at least not as of our Friday noon deadline. Once again, credit market action this week was dominated by the ebb and flow of discount rate rumors, with only very modest net rate moves. Rates rose early on, responding to the lack of a discount rate cut last week and to some unpalatable money data on Monday. After mid-week, however, rates eased back, led by a decline in the Fed funds rate that revived hopes for an imminent discount rate cut. By Friday noon, most rates were a shade below week-earlier levels, with Fed funds at 9.0% from the recent 9.25%-9.50% range.

Many market participants are betting on a discount rate cut this afternoon, a key to the improved market tone late this week. If a cut doesn't come today, a lot of people will be disappointed, and markets will likely weaken until the next round of discount-rate-cut hopes takes hold--though it will be interesting to see how markets react if Fed funds stay down at 9% with no discount rate cut. If a cut does come today, some cheering is likely, but this will be restrained by the fact that a half-point cut is already largely discounted in current market yields.

A discount rate cut today could leave markets at loose ends, once the initial relief is over. This is because it is harder to form expectations on Fed policy since the Fed de-emphasized short-term movements in M1. Mr. Volcker announced that shift after the October 5 Federal Open Market Committee meeting, attributing it to technical factors that were temporarily distorting M1. The shift cheered everyone enormously, but it also raised big questions. How long is temporarily? How much weight now goes to M2 and the other M's, how much stays with M1, and how much goes to other factors (whatever they may be)? How much money growth (in M1, M2, or MX) is tolerable, under the new rules? To sum it up, what are those new rules of the game, to the extent that any rules exist in a hard-and-fast form?

Some of these questions may be answered with this afternoon's release of the minutes of the October 5 FOMC meeting, but major uncertainties on Fed policy will likely remain. That makes discount rate changes--the most unequivocal sign of Fed intentions--of particular importance, and markets are likely to remain focused on possible discount rate moves. The Fed funds rate is also important (it is of more than passing interest that the recent drop in funds immediately followed the November FOMC meeting); but for now at least, the discount rate has pride of place. Because of this, a discount rate cut today could be followed by a brief hiatus and then by a rapid return to the markets' recent dominant activity--waiting for the next discount rate cut.

So much for this week's edition of the discount rate chronicles; we hope for a somewhat broader focus soon, and would like to take this opportunity to wish our readers a very happy Thanksgiving.

Anne Parker Mills

Irving Trust

Market Yields

	11/19/82 (Noon)	Week Ago	Year Ago
Prime Lending Rate at Irving Trust Company	12.00%	12.00%	16.50%
Effective since	10/13/82		
Discount Rate at Federal Reserve Bank	9.50	9.50	13.00
Federal Funds	9.00	9.50	12.50
Repurchase Agreements	8.88	9.13	11.00
U.S. Treasury Issues			
Bills			
3 months	8.34	8.48	10.43
6 months	8.63	8.92	11.27
1 year	8.98	9.15	11.59
Coupons			
2 years	9.73	9.81	12.16
4 years	10.21	10.29	12.86
7 years	10.53	10.58	13.20
10 years	10.40	10.54	13.04
Long Bond	10.32	10.42	13.03
Negotiable Certificates of Deposit-Secondary Market			
1 month	8.85	8.95	11.80
3 months	8.95	9.10	11.75
6 months	9.05	9.30	11.90
1 year	9.40	9.75	12.40
Banker's Acceptances			
1 month	8.90	8.85	11.71
3 months	9.00	8.90	11.63
6 months	9.05	8.95	11.75
Eurodollar Deposits			
1 month	9.56	9.63	12.38
2 months	9.63	9.75	12.44
3 months	9.81	9.88	12.50
Commercial Paper - Prime Names			
Directly placed by:			
Finance Companies			
1 week	8.50	8.75	11.38
1 month	8.75	8.75	11.38
3 months	8.63	8.50	11.38
Bank Holding Companies			
1 month	8.63	7.75	11.25
Dealer Placed:			
3 months	8.38	8.13	11.70
New AA Corporate Utility Bond	11.80	11.90	15.38
Tax Exempt			
6 month Project Notes	4.85	4.00	6.60
1 year AAA Bond	5.50	5.50	7.75
5 year AAA Bond	7.00	7.00	8.40
20 year AAA Bond	9.50	9.40	11.00

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Financial Markets

Irving Trust

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**Economic Research &
Planning Division**

Friday
(Noon)

Nov. 26, 1982

There wasn't much Thanksgiving spirit in the credit markets this week, as trading thinned around the holiday (which many extended into a four-day weekend, cutting volume further), and as markets chose to look on the dark side wherever possible. The discount rate cut was poorly received, with rates on many instruments rising early in the week. Later on, some improvement occurred as Federal funds remained well below 9%, but even this didn't put much steam in the markets, and many rates closed above week-ago levels. Next week, the climate could brighten remarkably if funds remain low; but until then, "glum and inconclusive" sums up market mood.

The long-awaited half-point cut in the discount rate to 9% didn't produce even the very modest positive response that we expected. Some rates did back off in late-Friday trading just after the announcement; but by the time markets opened up on Monday, dealers had evidently reconsidered, and the general structure of rates (though not Fed funds or CD rates) backed up significantly. Bond prices were hit, with the price on the new 30-year government bond falling by over a point. Why the negative response? Presumably, the discount rate cut had been more than fully discounted, with some bets placed on a full-point cut. Also, the delay in the move may have prompted fears that it was the last in a series.

To some extent, those fears were offset by the behavior of the Federal funds rate. For several weeks up to mid-November, funds traded in a range around 9.5%. Late last week, however, the funds rate began to ease, and that move continued this week with funds moving into an 8%-8.5% range. The jury is still out, however, on whether or not the downward move will last. Markets have been misled before by temporary swings in funds that have turned out to be the result of technical factors rather than of changes in Fed policy, and markets this week were in no mood to take big chances on what could be simply a temporary aberration.

The "real" level of Fed funds will be tested next Monday and Tuesday. The current statement week is one in which projections show a substantial Federal Reserve "add" need--that is, one in which reserve flows are such that the Fed will have to supply substantial liquidity to the reserves market if the Fed funds rate is not to rise. Wednesday is the last day of the statement week, with Fed activity expected before that point. If the funds rate, therefore, remains well below 9% in Monday and Tuesday trading, markets are likely to take this as a sign that the Fed really does find a lower funds rate acceptable, and a positive response is likely.

Trading early next week, then, should give some sense of direction to this week's inconclusive pattern. Confirmation of a lower funds rate will create expectation of another discount rate cut; waiting for that could keep markets busy until trading slows to a trickle around Christmas. A move back up in Federal funds would be likely to produce a continuation of this week's depressed tone. Whichever way it goes, the focus is likely to remain on the discount rate/Fed funds nexus until the new year, when the convening of the new Congress may focus attention on possible jobs spending, defense cuts, and Treasury financing prospects.

Anne Parker Mills

Irving Trust

Market Yields

	11/26/82 (Noon)	Week Ago	Year Ago
Prime Lending Rate at Irving Trust Company	11.50%	12.00%	16.50%
Effective since	11/22/82		
Discount Rate at Federal Reserve Bank	9.00	9.50	13.00
Federal Funds	8.25	9.00	12.50
Repurchase Agreements	8.25	8.88	11.00
U.S. Treasury Issues			
Bills			
3 months	8.25	8.34	10.43
6 months	8.68	8.63	11.27
1 year	9.08	8.98	11.59
Coupons			
2 years	9.79	9.73	12.16
4 years	10.35	10.21	12.86
7 years	10.69	10.53	13.20
10 years	10.58	10.40	13.04
Long Bond	10.50	10.32	13.03
Negotiable Certificates of Deposit-Secondary Market			
1 month	8.40	8.85	11.80
3 months	8.60	8.95	11.75
6 months	8.95	9.05	11.90
1 year	9.30	9.40	12.40
Banker's Acceptances			
1 month	8.40	8.90	11.71
3 months	8.65	9.00	11.63
6 months	8.95	9.05	11.75
Eurodollar Deposits			
1 month	9.00	9.56	12.38
2 months	9.50	9.63	12.44
3 months	9.75	9.81	12.50
Commercial Paper - Prime Names			
Directly placed by:			
Finance Companies			
1 week	8.13	8.50	11.38
1 month	8.25	8.75	11.38
3 months	8.38	8.63	11.38
Bank Holding Companies			
1 month	8.25	8.63	11.25
Dealer Placed:			
3 months	8.13	8.38	11.70
New AA Corporate Utility Bond	11.95	11.80	15.38
Tax Exempt			
6 month Project Notes	4.55	4.85	6.60
1 year AAA Bond	5.25	5.50	7.75
5 year AAA Bond	7.30	7.00	8.40
20 year AAA Bond	9.00	9.50	11.00

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12/7/82

Financial Markets

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**Economic Research &
Planning Division**

Friday (Noon)
Dec. 3, 1982

It was another indecisive week in the credit markets, with most participants still looking for more rate drops but afraid to anticipate them, leaving markets without much immediate sense of direction. The week began on a downbeat, with rate gains and price losses--upward pressure on the Federal funds rate disappointed hopes of an immediate discount rate cut. Later in the week, however, discount rate cut hopes revived (this time on European rate cuts and U.S. unemployment, the Federal funds rate having proved an unsatisfactory bellwether), and rates edged down. The week closed with little net change from last Friday's levels, continuing the recent pattern of muddling about while waiting for the next discount rate cut.

Last week's drop in Fed funds to 8%-8.25%, as it turns out, belongs, for now at least, in the temporary aberration file. This Monday and Tuesday, funds firmed up toward 9%; the market was disappointed because the Fed did not add reserves this week in an effort to hold funds at last week's low levels. This leaves funds a bit below the discount rate, which does not signal any imminent discount rate cut.

The fact that the funds rate was not adjusted down this week and last, however, does not mean that it will not be adjusted down fairly soon. At present, the Fed is clearly paying close attention to economic developments, and recent news is grim. The 10.8% November unemployment rate announced today surprised most observers, who had expected only a marginal change from October's 10.4%. Unless unmistakable signs appear very soon of an economic recovery extending beyond the housing sector, the Fed is likely to notch rates down at least one more time; indeed, the central bank may move before waiting for more grim economic data to be reported.

One news item that many observers seized upon to support this week's discount rate cut hopes was a round of reductions in European interest rates--the idea being that this was Phase I in a coordinated international round of rate reductions that will involve the Fed. In our view, the Fed will cut the discount rate again, but not because of international agreements; that has not been its pattern despite occasional rounds of rumor to that effect. What is interesting about the European rate cuts is the reason for their timing. European governments have been more interested than the U.S. authorities (if that is possible) in bringing down rates, but their ability to cut rates has been limited by the strength of the dollar, even after last summer's U.S. rate plunge. Now, the dollar appears to be weakening without much reference to interest rates, in part in response to a looming 1983 U.S. current account deficit of massive proportions.

If in fact the dollar has begun a sustained and substantial decline, this has implications for U.S. financial markets. On the one hand, the big inflows of foreign funds that have contributed to recent gains in U.S. bond and equities markets may subside, as potential currency losses weigh against potential capital gains in foreign investors' minds. On the other hand, European central banks may intervene to limit the dollar's drop for competitive reasons. This would mean purchases of U.S. government securities, which could, as in the late 1970s, ease the burden of government deficits on U.S. financial markets.

Anne Parker Mills

Irving Trust

Market Yields

	12/3/82 (Noon)	Week Ago	Year Ago
Prime Lending Rate at Irving Trust Company	11.50%	11.50%	15.75%
Effective since	11/22/82		
Discount Rate at Federal Reserve Bank	9.00	9.00	12.00
Federal Funds	8.88	8.25	11.75
Repurchase Agreements	8.75	8.25	11.25
U.S. Treasury Issues			
Bills			
3 months	8.14	8.25	10.40
6 months	8.72	8.68	10.95
1 year	9.07	9.08	11.35
Coupons			
2 years	9.70	9.79	12.10
4 years	10.30	10.35	12.80
7 years	10.58	10.69	13.30
10 years	10.46	10.58	13.05
Long Bond	10.47	10.50	12.85
Negotiable Certificates of Deposit-Secondary Market			
1 month	8.50	8.40	11.40
3 months	8.65	8.60	11.30
6 months	8.80	8.95	11.60
1 year	9.20	9.30	12.40
Banker's Acceptances			
1 month	8.50	8.40	11.20
3 months	8.65	8.65	11.26
6 months	8.90	8.95	11.53
Eurodollar Deposits			
1 month	9.31	9.00	12.25
2 months	9.50	9.50	12.25
3 months	9.63	9.75	12.25
Commercial Paper - Prime Names			
Directly placed by:			
Finance Companies			
1 week	8.63	8.13	11.25
1 month	8.50	8.25	11.38
3 months	8.38	8.38	11.13
Bank Holding Companies			
1 month	7.50	8.25	10.75
Dealer Placed:			
3 months	8.13	8.13	11.13
New AA Corporate Utility Bond	12.00	11.95	15.38
Tax Exempt			
6 month Project Notes	4.85	4.55	6.60
1 year AAA Bond	5.00	5.25	7.75
5 year AAA Bond	7.00	7.30	8.70
20 year AAA Bond	9.50	9.00	11.25

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Financial Markets

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**Economic Research &
Planning Division**

Friday
(Noon)

Dec. 10, 1982

Interest rates edged higher over the course of the week after starting out with initial drops. The net result? Little change from Friday to Friday, continuing the general muddle that has characterized markets since the latest (November 19) discount rate cut. This week's negative mood reflected the fading of hopes for a near-term discount rate cut, concern with a heavy supply of Treasury offerings that will be coming on over the next few weeks, and some worries about money supply data (M2 data in particular) to be released this afternoon.

In addition, year-end is setting in. The usual thinning in volume is accentuated by the fact that this was a very good year indeed for many market participants. Because of this, many are unwilling to risk diluting attractive results by making commitments this late in the year, particularly when there is not much temptation to buy. At current yields, the market is fairly priced relative to a 9% discount rate and an 8.5%-9% Fed funds rate. Without some news that would shift this relationship and create a real reason to buy (a "Christmas gift" discount rate cut after the next FOMC meeting, maybe?), there seems little reason to expect any near-term outbreak of good cheer in the credit markets.

Fed moves this week provided little fuel for discount rate cut hopes. Reverses on Tuesday sent market nerves skittering, and the Fed's injection of reserves on Thursday through outright bill purchases was only partially reassuring. Usually this would be done on Wednesday for Thursday settlement; the delay could reflect Fed interest in holding up the Fed funds average for the week and is hardly encouraging. With heavy seasonal add needs coming up, near-term slippage in the funds rate could be on the upside. Supply prospects were also somewhat discouraging, with $12 billion in 4- and 7-year notes to be auctioned next week, and 7- and 10-year issues to be announced for auction in the following week.

Finally, a substantial November M2 increase--$19 to $22 billion--is expected to be announced this afternoon. Money supply data are no longer so critical to market mood as was the case before Mr. Volcker's October announcements, but money supply data can still make markets nervous.

Whatever the market response to today's data, Fed response to money supply data is likely in our view to remain indeterminant for some time. Money data have already been distorted by the maturation of the all-savers certificates; now, new distortions will appear with the introduction of bank accounts similar to money market funds. There will be two types of accounts. One, the "super-NOWs," will only be available to individuals, with a $2,500 minimum balance and unlimited checking. This will be subject to the 12% reserve requirement imposed on demand deposits and will almost certainly be included in M1. The other account, available to corporations and institutions as well as to individuals, will be limited to six transfers per month. Its position in the M's has not yet been clarified. Given these two new instruments, deposit shifts into and out of the various M's in early 1983 are likely to be very substantial, leading to erratic behavior in the M's.

Anne Parker Mills

Irving Trust

Market Yields

	12/10/82 (Noon)	Week Ago	Year Ago
Prime Lending Rate at Irving Trust Company	11.50%	11.50%	15.75%
Effective since	11/22/82		
Discount Rate at Federal Reserve Bank	9.00	9.00	12.00
Federal Funds	8.88	8.88	12.38
Repurchase Agreements	8.75	8.75	12.25
U.S. Treasury Issues			
Bills			
3 months	8.23	8.14	11.24
6 months	8.76	8.72	12.34
1 year	9.02	9.07	12.75
Coupons			
2 years	9.78	9.70	13.29
4 years	10.47	10.30	13.70
7 years	10.78	10.58	13.98
10 years	10.59	10.46	13.81
Long Bond	10.54	10.47	13.51
Negotiable Certificates of Deposit-Secondary Market			
1 month	8.60	8.50	12.70
3 months	8.80	8.65	12.70
6 months	9.00	8.80	13.30
1 year	9.40	9.20	13.60
Banker's Acceptances			
1 month	8.60	8.50	12.30
3 months	8.80	8.65	12.70
6 months	9.10	8.90	13.25
Eurodollar Deposits			
1 month	9.56	9.31	13.25
2 months	9.63	9.50	13.38
3 months	9.75	9.63	13.63
Commercial Paper - Prime Names			
Directly placed by:			
Finance Companies			
1 week	8.63	8.63	12.13
1 month	8.63	8.50	12.13
3 months	8.38	8.38	11.75
Bank Holding Companies			
1 month	7.50	7.50	11.25
Dealer Placed:			
3 months	8.50	8.13	11.75
New AA Corporate Utility Bond	12.00	12.00	16.25
Tax Exempt			
6 month Project Notes	4.90	4.85	7.00
1 year AAA Bond	5.25	5.00	8.00
5 year AAA Bond	7.00	7.00	9.25
20 year AAA Bond	9.50	9.50	12.10

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84750-1
12/23/82

Financial Markets

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Economic Research &
Planning Division

Friday
(Noon)

Dec. 17, 1982

1982, the year of the big bang in the bond markets, is fading out with something of a whimper. This week, prices fell and rates rose, despite the Fed's surprise Monday discount rate cut, as the Treasury financing (Part I) hit markets that weren't very interested. Analysts offered complex fundamental explanations for the glum reception of the financing. These stressed fears of rate jumps ahead, stemming from an economic rebound that would reignite inflation and demand for credit, and/or from possible Fed response to recent rapid monetary growth.

The critical explanation for the markets' disinterest in the financing, however, may be much simpler. 1982 saw dramatic bond price gains, lots of people made lots of money, and few want to risk that with big position shifts before year-end. Another depressant this week was asset selling by money market mutual funds to cover withdrawals. On Tuesday, banks and savings institutions began offering money market accounts (often at initial premium rates); this new competition was presumably a factor in the $4.7 billion (2%) drop in assets held in money market funds in the week ended December 15. Finally, the continuing drop in the U.S. dollar is very probably reducing foreign interest in dollar-denominated assets.

So much for this week; next week may not be much brighter, given that the Treasury will offer $7.5 billion in longer-term issues, and that dealer participation may fade to the vanishing point as the holiday season moves into high gear. Indeed, markets may be very distorted over the next two weeks--what with problems in the longer-term markets and year-end bank positioning distorting short-term markets--and we would not look for basic trends in near-term developments.

What then of prospects for 1983? From October 1979 through mid-1982, interest rates (and through interest rates the money supply) tended to lead the economy. In 1983, the economy may well lead interest rates. This is based on the assumption that monetary targeting will not be reintroduced as the primary policy goal soon. There are technical grounds for this (what is money, given the rapid changes taking place in the financial structure?) and even more compelling economic and financial grounds--12 million unemployed in the U.S., and a severely strained worldwide (and dollar-denominated) financial system. Given these factors, the Fed may continue to pursue a policy focused primarily on real economic trends and considerations of financial stability for some time.

This implies that the scope for interest rate increases is very limited, and that further modest declines are likely, particularly in early 1983. We do project a muted U.S. recovery in 1983, but do not expect this to bring the rate of unemployment below 10%, and do not expect it to reignite inflationary pressure, given potential productivity gains and weak commodities (especially oil) prices. If the economy fails to recover, the Fed is likely to continue to let rates fall, perhaps to levels well below the current range of expectations.

This is our last issue until 1983, and we would like to wish all our readers a joyous holiday season and a happy, healthy and prosperous New Year.

Anne Parker Mills

Irving Trust

Market Yields

	12/17/82 (Noon)	Week Ago	Year Ago
Prime Lending Rate at Irving Trust Company	11.50%	11.50%	15.75%
Effective since	11/22/82		
Discount Rate at Federal Reserve Bank	8.50	9.00	12.00
Federal Funds	8.75	8.88	12.25
Repurchase Agreements	8.75	8.75	12.00
U.S. Treasury Issues			
Bills			
3 months	8.02	8.23	11.40
6 months	8.43	8.76	12.35
1 year	8.74	9.02	12.65
Coupons			
2 years	9.58	9.78	13.25
4 years	10.11	10.47	13.80
7 years	10.71	10.78	13.85
10 years	10.58	10.59	13.60
Long Bond	10.67	10.54	13.38
Negotiable Certificates of Deposit-Secondary Market			
1 month	8.70	8.60	12.60
3 months	8.70	8.80	12.85
6 months	8.85	9.00	13.30
1 year	9.25	9.40	13.60
Banker's Acceptances			
1 month	8.70	8.60	12.50
3 months	8.75	8.80	12.80
6 months	8.95	9.10	13.25
Eurodollar Deposits			
1 month	9.56	9.56	13.13
2 months	9.56	9.63	13.25
3 months	9.69	9.75	13.38
Commercial Paper - Prime Names			
Directly placed by:			
Finance Companies			
1 week	8.50	8.63	11.50
1 month	8.50	8.63	12.38
3 months	8.25	8.38	12.25
Bank Holding Companies			
1 month	7.25	7.50	11.50
Dealer Placed:			
3 months	8.13	8.50	12.00
New AA Corporate Utility Bond	12.40	12.00	16.40
Tax Exempt			
6 month Project Notes	4.70	4.90	7.10
1 year AAA Bond	5.00	5.25	7.50
5 year AAA Bond	6.70	7.00	9.25
20 year AAA Bond	9.20	9.50	12.00

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Financial Markets

Irving Trust

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Economic Research &
Planning Division

Friday
(Noon)

Jan. 14, 1983

Since the October meeting of the FOMC and Mr. Volcker's statements before the Joint Economic Committee in late November, the money markets have come to focus more on interest rate movements than on money supply. Thus the recent cut in the bank prime lending rate to 11% has been viewed as an indication that the Federal Reserve might reduce the discount rate soon. This logic, though broadly correct points to a changed emphasis in the operations of the Federal Reserve. While this shift in emphasis is apparent, Mr. Volcker has tried to make clear that a shift in Federal Reserve policy has not occurred. What does this mean?

The Federal Reserve bases policy upon both abstract economic principles and economic realities. The new wrinkle in the Fed's intentions in late 1982 is best seen as putting several more steps between the conduct of monetary policy and strict monetarism. Yet the Fed's fight against inflation continues, and the primary intermediate operating target remains the nonborrowed reserves path that the Fed sets. Even as there is a growing concern by the Fed over the level of interest rates, policy rhetoric focuses on problems with the monetary aggregates and the necessary accommodations. As an intermediate target, M1 has become far less important.

In his address of November 24 to the Joint Economic Committee, the Chairman stressed the importance of the provision of bank reserves as an operating instrument. He also suggested that precautionary liquidity motives by the public should be accommodated to avoid an unintended tightening. This possible conflict, together with the problems posed for the monetary aggregates by the new accounts banks are allowed to offer, the super NOW account and the insured money market account, means that the Fed's likely reaction to above-target money growth is not clearly defined. The relatively greater weight placed on the monetary aggregate M2 is not too helpful because we only observe this aggregate once per month and because it is not itself free of distortions. On a day-to-day basis, the market has focused on movements in the Fed funds rate as policy. Indeed, the Fed funds rate has become remarkably stable.

While this view is too simplistic, it is roughly accurate. On the one hand, the Fed has little scope to allow interest rates to rise because of the weak state of the economy and the difficult international debt situation. In addition, the political cycle favors a lowering of interest rates. Yet the Fed wishes to keep from igniting another round of inflation. Only one action is consistent with these objectives: a slow downtrend in interest rates, at least until the economy begins to pick up. In terms of the monetary aggregates, any excessive monetary growth might be attributed to precautionary liquidity motives until the economy has shown some growth.

Prospects for success depend on developments in the real economy and in unemployment. Without some near-term improvement in economic activity, interest rates will have to be reduced somewhat faster than the Fed would like, posing an inflation risk. For now, however, the steady and slow course seems feasible. There has been enough strength in auto sales recently and other indicators to permit such an approach. Currently, the Fed is under no pressure, except from expectant market participants, for a discount rate cut. The Fed may choose to wait for further economic news; it might react sooner if M2 growth turns out to be slower than expected.

Robert A. Brusca

Irving Trust

Market Yields

	1/14/83 (Noon)	Week Ago	Year Ago
Prime Lending Rate at Irving Trust Company	11.00%	11.50%	15.75%
Effective since	1/11/83		
Discount Rate at Federal Reserve Bank	8.50	8.50	12.00
Federal Funds	8.38	8.25	12.38
Repurchase Agreements	8.38	8.25	12.00
U.S. Treasury Issues			
Bills			
3 months	7.92	8.13	12.69
6 months	8.08	8.29	13.97
1 year	8.36	8.58	14.41
Coupons			
2 years	9.10	9.34	14.70
4 years	9.60	9.88	14.76
7 years	10.13	10.29	14.80
10 years	10.24	10.34	14.76
Long Bond	10.40	10.44	14.35
Negotiable Certificates of Deposit-Secondary Market			
1 month	8.10	8.30	12.75
3 months	8.15	8.35	13.50
6 months	8.25	8.40	14.35
1 year	8.65	8.85	14.50
Banker's Acceptances			
1 month	8.05	8.25	12.65
3 months	8.10	8.30	13.45
6 months	8.30	8.40	14.35
Eurodollar Deposits			
1 month	8.75	8.88	13.44
2 months	8.75	8.88	13.81
3 months	8.75	8.88	14.00
Commercial Paper - Prime Names			
Directly placed by:			
Finance Companies			
1 week	7.88	6.00	12.50
1 month	8.00	8.00	12.50
3 months	8.13	8.25	12.63
Bank Holding Companies			
1 month	7.75	8.00	12.25
Dealer Placed:			
3 months	8.04	8.25	NA
New AA Corporate Utility Bond	12.35	12.25	17.25
Tax Exempt			
6 month Project Notes	4.40	4.65	7.50
1 year AAA Bond	4.50	5.25	8.25
5 year AAA Bond	6.15	6.20	9.50
20 year AAA Bond	8.60	8.90	12.30

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Financial Markets

Irving Trust

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**Economic Research &
Planning Division**

Friday
(Noon)

Jan. 21, 1983

The market quieted on the question of a possible discount rate cut by the Federal Reserve this week--what better time for one to occur? Talk had centered around the prospect for a rate easing to soften up Congress prior to Mr. Volcker's February testimony before the banking committees, where the monetary growth targets for this year will be laid out. While still an intriguing prospect, other events of the past week may provide the scope for the Fed to cautiously lower its discount rate again.

Economic data released during the week, while not abysmal, were generally in the pessimistic ranges of the market's expectations. Industrial production declined in December, but at a slower rate than in the recent past. Last month's spurt in housing starts reversed but left a clear modest uptrend. Last year's real growth registered a 2.5% (annual rate) decline in the fourth quarter, leaving the year down by 1.8% overall, the worst decline since 1946. The good news was the modest 0.1% uptick in December's finished goods prices, accompanied by a much better than expected 0.3% decline in the consumer price index. Thus, 1982 concludes with the lowest rate of CPI inflation in the past decade. Taken alone none of these factors is of great significance. Together, however, they form for policymakers a picture of a continued very weak economy, with at best hope--certainly not signs--of an incipient recovery. Progress on inflation provides scope for a rate cut, while protracted economic weakness offers sound rationale.

Internationally, pressure seems to have intensified for a coordinated reflation. The Group of Ten, a body consisting of ten major industrialized countries, agreed to provide the International Monetary Fund with $12 billion in new resources to help other financially strapped IMF member countries. This follows an agreement "in principle" last month to increase the IMF's quotas and, thus, its basic capability to lend by 50%. Treasury Under Secretary Beryl Sprinkel was quoted as calling for economic stimulation, a quote which led Treasury Secretary Regan to state that Mr. Sprinkel spoke for himself, not the Administration, and that there had been no change in basic policy.

These events, some of them reflecting longer-term problems, indicate the continued turmoil among policymakers, who see a need to reflate but wish to avoid stimulating inflation. The political and economic situation abroad, best exemplified by the failure of the Bundesbank to lower key West German interest rates, points to a continued need for the U.S. to go first or join in on any interest rate cutting. The dollar certainly can take it. Perhaps the strongest factor weighing against a Fed decision to drop the discount rate is the bond market's reaction to the last cut--yields rose. Nonetheless, myriad factors point the other way. Indeed, if the bond market has not already discounted the discount rate cut, the market might even react favorably.

Robert A. Brusca

Irving Trust

Market Yields

	1/21/83 (Noon)	Week Ago	Year Ago
Prime Lending Rate at Irving Trust Company	11.00%	11.00%	15.75%
Effective since	1/11/83		
Discount Rate at Federal Reserve Bank	8.50	8.50	12.00
Federal Funds	8.13	8.38	13.63
Repurchase Agreements	8.13	8.38	12.88
U.S. Treasury Issues			
Bills			
3 months	8.16	7.92	13.45
6 months	8.49	8.08	14.40
1 year	8.78	8.36	14.97
Coupons			
2 years	9.36	9.10	15.02
4 years	9.93	9.60	14.87
7 years	10.47	10.13	14.72
10 years	10.51	10.24	14.64
Long Bond	10.74	10.40	14.23
Negotiable Certificates of Deposit-Secondary Market			
1 month	8.10	8.10	13.50
3 months	8.30	8.15	14.00
6 months	8.55	8.25	14.65
1 year	8.85	8.65	15.00
Banker's Acceptances			
1 month	8.05	8.05	13.25
3 months	8.05	8.10	14.00
6 months	8.10	8.30	14.60
Eurodollar Deposits			
1 month	8.88	8.75	14.00
2 months	9.00	8.75	14.38
3 months	9.00	8.75	14.63
Commercial Paper - Prime Names			
Directly placed by:			
Finance Companies			
1 week	7.00	7.88	13.00
1 month	7.63	8.00	13.13
3 months	7.75	8.13	13.25
Bank Holding Companies			
1 month	7.13	7.75	12.50
Dealer Placed:			
3 months	7.38	8.04	12.63
New AA Corporate Utility Bond	12.65	12.35	17.00
Tax Exempt			
6 month Project Notes	4.60	4.40	7.10
1 year AAA Bond	5.00	4.50	8.10
5 year AAA Bond	6.10	6.15	8.90
20 year AAA Bond	8.60	8.60	12.20

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Financial Markets

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**Economic Research &
Planning Division**

Friday
(Noon)

Jan. 28, 1983

Until Mr. Volcker appears before Congress and presents the Federal Reserve's 1983 objectives for money and credit, financial market participants will have a difficult time divining Fed policy. Since the Fed has put aside M1 as a short-run intermediate target (or indicator), it is not clear how the Fed's week to week policy is being set. (Recall that M1 has been downgraded because of distortions stemming from the newly authorized bank accounts, maturing All Savers Certificates, and strong liquidity demands by the public.) Therefore, it has been impossible to know how the Fed has been determining the proper level of reserves to supply to the banking system. So far, the Fed has accommodated the above-target growth of M1 by readily providing reserves to support its growth. When will the honeymoon be over?

The February meeting with Congress will supply the answer. At that time, the Fed probably will adopt a more deterministic operating procedure. The Fed has been urged to target credit or real interest rates rather than monetary aggregates. Indeed, the Fed itself has conducted studies of the feasibility and desirability of such changes. These approaches have benefits but are not without their drawbacks, and the Fed is more likely to consider a modification in its current methods. Problems in money-aggregates targeting are well known and their nature well understood. A totally new policy approach would inject considerable uncertainty into already difficult times. As a result, it is far more likely that the Fed will either offer new targets for 1983, built on a monetary foundation bloated by deposit shifts into the newly authorized bank accounts, or will once again try a shift-adjusted monetary aggregate. Past experience with shift adjustment has not been good; thus the Fed would be reluctant to try it again. However, the new Money Market Deposit Accounts (MMDAs) have been around since early December, long enough to provide data on the already large shift. Super NOW accounts are a more difficult problem, coming into existence a month later. But these new accounts are not the core of the Fed's problems.

M1 had been growing at above-target rates before the new bank accounts were offered. If that excessive growth stemmed from All Savers money, parked there temporarily, why hasn't it moved out yet? The banks' MMDA accounts, contained in M2, already have attracted $147 billion. Thus the real problem is the excessive growth in M1 and does not seem due to the new bank accounts. So far, Mr. Volcker has been able to put this aside: the income velocity of M1 has shifted. This means people have been holding more money relative to income, and the excessive monetary growth has not been inflationary. But over the rest of the year will velocity growth snap back? Will the Fed be forced to resist a resurgent money supply later in 1983 to ward off inflation? A velocity snapback is what monetarists fear. We will hear something of what the Fed will do when Mr. Volcker addresses Congress, sometime before February 20. Until then, there is a clear and present need for lower interest rates. Yet how long can the money supply be allowed to grow so fast without igniting fears of inflation? This is Mr. Volcker's policy dilemma.

Robert A. Brusca

Irving Trust

Market Yields

	1/28/83 (Noon)	Week Ago	Year Ago
Prime Lending Rate at Irving Trust Company	11.00%	11.00%	15.75%
Effective since	1/11/83		
Discount Rate at Federal Reserve Bank	8.50	8.50	12.00
Federal Funds	8.25	8.13	14.00
Repurchase Agreements	8.25	8.13	13.25
U.S. Treasury Issues			
Bills			
3 months	8.31	8.16	13.00
6 months	8.55	8.49	13.69
1 year	8.87	8.78	14.02
Coupons			
2 years	9.48	9.36	14.22
4 years	10.02	9.93	14.20
7 years	10.59	10.47	14.22
10 years	10.66	10.51	14.14
Long Bond	10.82	10.74	13.90
Negotiable Certificates of Deposit-Secondary Market			
1 month	8.30	8.10	13.70
3 months	8.50	8.30	13.95
6 months	8.80	8.55	14.30
1 year	9.00	8.85	14.70
Banker's Acceptances			
1 month	8.35	8.05	13.50
3 months	8.50	8.05	13.95
6 months	8.85	8.10	14.35
Eurodollar Deposits			
1 month	9.00	8.88	14.13
2 months	9.13	9.00	14.50
3 months	9.25	9.00	14.50
Commercial Paper - Prime Names			
Directly placed by:			
Finance Companies			
1 week	8.25	7.00	13.25
1 month	8.25	7.63	13.50
3 months	8.25	7.75	13.50
Bank Holding Companies			
1 month	8.00	7.13	13.13
Dealer Placed:			
3 months	8.26	7.38	13.65
New AA Corporate Utility Bond	12.65	12.65	16.50
Tax Exempt			
6 month Project Notes	4.50	4.60	7.20
1 year AAA Bond	5.25	5.00	6.80
5 year AAA Bond	6.30	6.10	9.00
20 year AAA Bond	8.80	8.60	11.90

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Financial Markets

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**Economic Research &
Planning Division**

Friday
(Noon)

Feb. 4, 1983

The recent statements of Mr. Volcker, Mr. Reagan, and Mr. Regan were very well received in the U.S. and in Europe, although there appears to be little change in the content of their messages. The conciliatory attitude between the Administration and the Fed seems to have been responsible for the change in mood--particularly Chairman Volcker's statement that economic growth must be achieved, and President Reagan's statement that the Fed must be allowed flexibility on money supply growth. Yet the Fed continues to be "worried" about inflation and stubborn at the current level of interest rates. Need rates move lower? What if they turn higher? Let's examine some of the consequences of these alternatives in more precise quantitative terms.

The current level of interest rates is high by historic comparison but low by recent experience. Inflation is low by recent experience but high by historic standards. Taking a reasonable 5% forecast for inflation, expected inflation-adjusted interest costs are 5% for the coming year--high by historic standards. This is also high in comparison with our important Western European trade partners, particularly West Germany where a 2½% inflation-adjusted rate applies. While strict international comparisons of interest-cost burdens are hard to achieve, the U.S. would appear to have room to move rates down. But this would probably weaken the dollar, refueling inflation.

A weaker dollar would bring inflation up but not discernibly, partly because the U.S. still benefits from past dollar strength. Since end-1979, the dollar has risen about 35% on a weighted average basis. Statistical evidence indicates that this appreciation tends to lower the price level in the U.S. by 8%. With lags of two to three years on the pass-through to domestic prices, we have yet to experience some of the recent gains; if the dollar weakens, we simply lose some of the gains that would otherwise be in the pipeline (perhaps 2%-3%).

The debt situation in the developing countries is another reason for interest rates to come down, and this problem seems to have occupied much of Chairman Volcker's time of late. According to the IMF's own estimates, a one percentage point rise in short-term interest rates increases nonoil-producing LDCs' annual interest payments by about $2 billion (about 1/2% of goods and services exports). For countries that have already compressed imports and pressed lenders for additional financing, this is a considerable sum. Moreover, to the extent lower interest rates stimulate growth in the developed countries, the LDCs benefit, particularly those which export manufactures--and these are the most indebted. The IMF calculates this group grows three-quarters of one percentage point for each one percentage point of real growth in the industrialized countries. In this environment growth would be export led.

It is hard to believe that these factors could be put aside because of excessive growth in an innovation-afflicted monetary aggregate. The inflation rate continues downward. The economy recovers because rates are lower, particularly because of low auto financing rates. Inflation needs to be fought but only with continued "rearguard" action. Domestic and world economic growth still requires rates to continue on a downward trend, even though we may experience modest backups from time to time.

Robert A. Brusca

Irving Trust

Market Yields

	2/4/83 (Noon)	Week Ago	Year Ago
Prime Lending Rate at Irving Trust Company	11.00%	11.00%	16.50%
Effective since	1/11/83		
Discount Rate at Federal Reserve Bank	8.50	8.50	12.00
Federal Funds	8.38	8.25	15.25
Repurchase Agreements	8.38	8.25	14.88
U.S. Treasury Issues			
Bills			
3 months	8.50	8.31	14.47
6 months	8.84	8.55	15.00
1 year	9.09	8.87	14.85
Coupons			
2 years	9.80	9.48	15.00
4 years	10.27	10.02	14.83
7 years	10.84	10.59	14.78
10 years	10.99	10.66	14.74
Long Bond	11.10	10.82	14.52
Negotiable Certificates of Deposit-Secondary Market			
1 month	8.45	8.30	15.10
3 months	8.70	8.50	15.30
6 months	9.00	8.80	15.40
1 year	9.40	9.00	15.40
Banker's Acceptances			
1 month	8.50	8.35	15.10
3 months	8.70	8.50	15.35
6 months	9.00	8.85	15.45
Eurodollar Deposits			
1 month	9.00	9.00	15.63
2 months	9.19	9.13	15.75
3 months	9.31	9.25	15.75
Commercial Paper - Prime Names			
Directly placed by:			
Finance Companies			
1 week	8.50	8.25	15.00
1 month	8.50	8.25	15.00
3 months	8.38	8.25	14.25
Bank Holding Companies			
1 month	8.00	8.00	14.38
Dealer Placed:			
3 months	8.43	8.26	14.88
New AA Corporate Utility Bond	12.60	12.65	17.00
Tax Exempt			
6 month Project Notes	4.50	4.50	7.40
1 year AAA Bond	5.00	5.25	7.65
5 year AAA Bond	6.25	6.30	9.00
20 year AAA Bond	8.80	8.80	12.30

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Financial Markets

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**Economic Research &
Planning Division**

Friday
(Noon)

Feb. 11, 1983

This afternoon, the Federal Reserve announces new definitions of the broad money aggregates M2 and M3; next Wednesday, Chairman Volcker goes before the Senate Banking Committee to lay out money and credit policy for the year ahead. What policy options exist and what policy will likely emerge? First, the near-term economic significance of the redefinition of the aggregates is negligible. As the Fed has not indicated that there will be a redefinition of M1, the market will not have a more credible week to week gauge by which to judge the Fed's likely policy response. However, if the Fed can construct a slower growing M2 (which otherwise would grow at a 35% annual rate in January), market psychology might be improved. If one monetary aggregate were not growing at an outrageous pace, the Fed might be seen as having scope to move interest rates (down!). In fact, the Fed's actual policy choices are bleak.

The Fed is, in some sense, caught between the dogmas of those who are monetarist and those who are not. The bond market has behaved as monetarists say it should in response to a surge in money growth, with yields backing-up after the last discount rate cut. M1 has grown at a 12% annual rate over the last six months; 15½% over the last three months. In this view, surely inflation is on the way. Nonmonetarists point to high nominal interest rates relative to current and forecasted rates of inflation. The economic recovery is only incipient and must be treated gently; this is not the time to raise interest rates, in this view. M1 velocity has shifted down sharply. Because of this and because it is unlikely that velocity will soon shift all the way back up, inflation (and the already rapid money growth) is not now to be so feared, the nonmonetarists argue.

In this environment the Fed must propose a credible, flexible monetary policy. The velocity issue is central. Setting policy involves forecasts of real GNP, inflation, and interest rates. Numerous forecast iterations are required before a "consistent" forecast is produced. Out of the process come various recommendations for money growth depending on velocity behavior. A policy course is selected by the FOMC, and the money growth target (primarily M1) is used to set a path for nonborrowed bank reserves. That path becomes the operating instrument of the Fed, subject to seasonal influences and some discretion.

The problem here is clear. Velocity behavior has been erratic and is almost impossible to predict. A wrong guess could leave us with a monetary policy much more contractionary than intended or much more expansionary. Indeed, this is why M1 was abandoned in October of last year. The Fed could propose much broader growth ranges for the aggregates, but this would lack credibility on inflation. Also, velocity has been so erratic that even such a policy might not be flexible enough. Shift adjusted aggregates, to allow for the new bank accounts, suffer from the same drawbacks. Instead, the Fed might emphasize more a broad money or credit aggregate. Another viable option would be to target M1 as usual with some specific stipulation as to how velocity behavior might alter the Fed's reactions to excessive (deficient) money growth. All in all a more discretionary and less rules-oriented policy is inevitable. The Fed can neither afford another bad miss of its yearly money targets nor to hit its targets at the expense of choking off recovery.

Robert A. Brusca

Irving Trust

Market Yields

	2/11/83 (Noon)	Week Ago	Year Ago
Prime Lending Rate at Irving Trust Company	11.00%	11.00%	16.50%
Effective since	1/11/83		
Discount Rate at Federal Reserve Bank	8.50	8.50	12.00
Federal Funds	8.50	8.38	15.88
Repurchase Agreements	8.38	8.38	15.00
U.S. Treasury Issues			
Bills			
3 months	8.39	8.50	14.73
6 months	8.66	8.84	15.06
1 year	8.93	9.09	14.89
Coupons			
2 years	9.64	9.80	14.91
4 years	10.10	10.27	14.74
7 years	10.61	10.84	14.62
10 years	10.78	10.99	14.65
Long Bond	10.87	11.10	14.47
Negotiable Certificates of Deposit-Secondary Market			
1 month	8.30	8.45	15.30
3 months	8.50	8.70	15.50
6 months	8.70	9.00	15.50
1 year	9.20	9.40	15.60
Banker's Acceptances			
1 month	8.30	8.50	15.35
3 months	8.45	8.70	15.50
6 months	8.70	9.00	15.55
Eurodollar Deposits			
1 month	8.78	9.00	16.00
2 months	9.00	9.19	16.13
3 months	9.13	9.31	16.25
Commercial Paper - Prime Names			
Directly placed by:			
Finance Companies			
1 week	8.38	8.50	15.25
1 month	8.38	8.50	15.13
3 months	8.38	8.38	14.50
Bank Holding Companies			
1 month	8.00	8.00	14.50
Dealer Placed:			
3 months	8.49	8.43	15.30
New AA Corporate Utility Bond	12.40	12.60	17.13
Tax Exempt			
6 month Project Notes	4.45	4.50	8.00
1 year AAA Bond	5.00	5.00	7.90
5 year AAA Bond	6.25	6.25	8.90
20 year AAA Bond	8.90	8.80	12.10

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Financial Markets

Irving Trust

Irving Trust Company
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**Economic Research &
Planning Division**

Friday
(Noon)

Feb. 18, 1983

Chairman Volcker's statements before the Senate Banking Committee, while long awaited, did little to dispel the uncertainty over the main thrust of Federal Reserve policy. Amid great complications, Mr. Volcker sought to leave the impression that the monetary aggregates' targets were unchanged in terms of their likely impact on the economy. However, the senators' questions showed less concern over the aggregates' targets than over the effect of interest rates on the economy. Here something interesting has happened; the Europeans seem to have drawn the conclusion that U.S. interest rates would be lower, while in the U.S. the focus has been on economic recovery as the prime objective. My reading of Mr. Volcker's statements (and my impression drawn from the meeting itself) is different: Mr. Volcker now seems more concerned about the control of inflation than the promotion of recovery.

Mr. Volcker's emphasis in his testimony was on the many temporary factors that have been responsible for the current progress on inflation: depressed commodity prices, a strong dollar, and cyclical economic factors. He stressed that there is "little or no leeway...for 'mistakes' on the side of inflation." He did not say the same about economic recovery. Moreover, he failed to turn aside Senator Riegle's characterization of the prepared text as more concerned with fighting inflation than promoting recovery. Senator Riegle persisted in asking if the current level of interest rates would allow sustained recovery. Mr. Volcker would only say he felt current rates would permit such recovery, but he could not be urged to say recovery was probable with current rates--he said we cannot know, but must wait and see.

For the time being, the recovery looks strong enough to Mr. Volcker to allow a shift in emphasis to fighting inflation. In the current context this means firm, but not higher, interest rates. I am puzzled by the interpretation of Mr. Volcker's statements as pro-recovery. While he is pro-recovery, that is not the emphasis. He seems to treat recovery as predetermined and is even cautious against overstimulation. Also curious is the European view that U.S. interest rates will go lower soon. It seems mostly built on wishful thinking--the evidence is not in Mr. Volcker's speech. The initial European reaction was to the breadth of the money supply targets and thoughts that money was to be less constraining to policy. But scope is not the same as action.

Continued deregulation of financial markets in the U.S. has led the Chairman to back off from the narrowest monetary aggregates--yet he intends to hit the targets he set. Most important is M3 with growth rates unchanged from last year. M2's target is one percentage point higher, and its base will be the February-March average to minimize the distortion of deregulation. M1 has a very broad 4%-8% target, but the Chairman said the desired position in this range will depend on the performance of velocity. The Chairman also said this would be a year of greater discretion. More than in the recent past, the outlook for interest rates will depend on the pure judgment of the Chairman and the FOMC.

Robert A. Brusca

Irving Trust

Market Yields

	2/18/83 (Noon)	Week Ago	Year Ago
Prime Lending Rate at Irving Trust Company	11.00%	11.00%	17.00%
Effective since	1/11/83		
Discount Rate at Federal Reserve Bank	8.50	8.50	12.00
Federal Funds	8.38	8.50	14.25
Repurchase Agreements	8.38	8.38	13.38
U.S. Treasury Issues			
Bills			
3 months	8.20	8.39	14.14
6 months	8.55	8.66	14.80
1 year	8.80	8.93	14.77
Coupons			
2 years	9.55	9.64	14.92
4 years	9.95	10.10	14.54
7 years	10.30	10.61	14.28
10 years	10.50	10.78	14.21
Long Bond	10.90	10.87	14.00
Negotiable Certificates of Deposit-Secondary Market			
1 month	8.35	8.30	15.00
3 months	8.45	8.50	15.05
6 months	8.65	8.70	15.15
1 year	9.15	9.20	15.15
Banker's Acceptances			
1 month	8.35	8.30	15.40
3 months	8.40	8.45	15.05
6 months	8.60	8.70	15.10
Eurodollar Deposits			
1 month	8.88	8.78	15.44
2 months	9.00	9.00	15.50
3 months	9.13	9.13	15.50
Commercial Paper - Prime Names			
Directly placed by:			
Finance Companies			
1 week	8.25	8.38	13.25
1 month	8.25	8.38	14.13
3 months	8.25	8.38	14.13
Bank Holding Companies			
1 month	7.25	8.00	14.00
Dealer Placed:			
3 months	8.00	8.49	14.63
New AA Corporate Utility Bond	12.20	12.40	16.50
Tax Exempt			
6 month Project Notes	4.20	4.45	8.00
1 year AAA Bond	4.80	5.00	8.00
5 year AAA Bond	6.30	6.25	9.00
20 year AAA Bond	8.90	8.90	12.25

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Financial Markets

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**Economic Research &
Planning Division**

Friday
(Noon)

Feb. 25, 1983

The downside break out in oil prices unsettled the financial markets this week and prompted speculation about how the Fed might react to this event. News that Nigeria lowered its oil price by $5.50 per barrel weakened the exchange value of the pound sterling and the dollar, and gold dropped sharply by $30 per oz. Concern over lower oil prices centers primarily on the impact of these lower prices on the debt-ridden LDCs whose revenues are dependent on the sale of oil. However, there are several other financial repercussions of lower oil prices, and most are positive. The drop in the price of gold undoubtedly reflects the belief of gold dealers that investors in traditional oil surplus states will have fewer financial resources to diversify into gold. The weakening of the dollar, which occurred later in the week, reflects speculation as to what the Federal Reserve might do in response to lower oil prices. What might we expect of the Fed?

Clues to the Fed's likely response are embedded in Chairman Volcker's recent remarks before the Senate Banking Committee. That testimony tilted toward fighting inflation; it discounted some of the progress made on the inflation front as being due to a combination of permanent *and temporary* factors. In that regard, lowering the contract price of oil would be a new, important, and *enduring* element in the outlook for inflation. A lower contract price for oil--even at unchanged spot oil prices--tends to reinforce market sentiment that lower oil prices will persist for some time. Through the salutary effects of this prospect on inflationary expectations, the Fed might gain room to let interest rates go lower.

Yet this result is not unambiguous. Lower oil prices by themselves will tend to stimulate the economy: A 12% drop in oil prices (about $4 per barrel) would stimulate real GNP in the U.S. by not quite 1/2%. Also, the economic recovery has already begun, and rapid growth in the money supply persists. Nevertheless, improved long-run prospects (plus continuing progress) on inflation coupled with ongoing international debt concerns still might tilt the Fed's decision toward lowering interest rates.

The job of stabilizing oil prices at a lower level is no easy task. Different needs exist among OPEC members and between OPEC and other oil producers. There is *no* prospect of oil prices falling to a level where they will be firmly underpinned by oil's marginal production cost. Oil price stability will depend on oil producers' recognition of their interdependence as well as on their mutual trust. Strong incentives will remain for the most financially strapped producers to undercut the market. As oil producers, taken as a group, have more to gain from an orderly price agreement than from having no agreement, a deal should be struck. This would be a positive factor in restoring global economic stability and confidence in the international financial system.

Robert A. Brusca

Irving Trust

Market Yields

	2/25/83 (Noon)	Week Ago	Year Ago
Prime Lending Rate at Irving Trust Company	11.00%	11.00%	16.50%
Effective since	1/11/83		
Discount Rate at Federal Reserve Bank	8.50	8.50	12.00
Federal Funds	8.13	8.38	13.38
Repurchase Agreements	8.05	8.38	12.50
U.S. Treasury Issues			
Bills			
3 months	8.13	8.20	12.82
6 months	8.29	8.55	13.87
1 year	8.58	8.80	14.00
Coupons			
2 years	9.28	9.55	14.29
4 years	9.72	9.95	14.07
7 years	10.19	10.30	13.95
10 years	10.25	10.50	13.89
Long Bond	10.47	10.90	13.68
Negotiable Certificates of Deposit-Secondary Market			
1 month	8.15	8.35	14.05
3 months	8.25	8.45	14.25
6 months	8.35	8.65	14.40
1 year	8.90	9.15	14.40
Banker's Acceptances			
1 month	8.27	8.53	13.95
3 months	8.49	8.70	14.87
6 months	8.71	8.98	15.35
Eurodollar Deposits			
1 month	8.88	8.88	14.50
2 months	8.94	9.00	14.81
3 months	8.94	9.13	14.94
Commercial Paper - Prime Names			
Directly placed by:			
Finance Companies			
1 week	8.12	8.38	13.35
1 month	8.17	8.42	13.84
3 months	8.28	8.54	14.04
Bank Holding Companies			
1 month	8.31	7.40	13.46
Dealer Placed:			
3 months	8.41	8.28	14.27
New AA Corporate Utility Bond	11.85	12.20	16.50
Tax Exempt			
6 month Project Notes	4.00	4.20	7.55
1 year AAA Bond	4.50	4.80	7.75
5 year AAA Bond	6.20	6.30	9.00
20 year AAA Bond	8.65	8.90	11.70

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Financial Markets

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**Economic Research &
Planning Division**

Friday
(Noon)

Mar. 4, 1983

The persisting improvement in bond prices even in the face of a sharp rise in the index of leading economic indicators demonstrates a strong upward momentum in bond prices. Although the leading economic indicators were augmented by a purely technical kick from the distorted monetary aggregate M2, the 3.6% rise in January was impressive. That bond prices continued to firm indicates a more fundamental and less technical reaction in the bond market itself. The bond market is beginning to focus more on long-term trends and is putting less weight on the likely reaction of the Federal Reserve. This development is due to several factors.

The gestation period following Chairman Volcker's Senate Banking Committee testimony is over. The result is that near-term fears of higher interest rates are removed. While uncertainty exists as to whether or not money market rates will go lower, the bond market is less closely tied to these rates because of new developments. Foremost is the prospect of lower oil prices and ongoing progress on inflation. This has cemented inflationary expectations at a much lower level. Also, recent statements by Chairman Volcker have reinforced and clarified his Senate testimony. His concerns for the future no longer address money supply issues. Instead, he speaks generally about inflation fears, applauds the prospect for lower oil prices, and repeats that his own personal feeling is that interest rates can move lower because of progress on inflation. This tone has generally encouraged the bond market.

With the fears of an uptick in bond rates evaporating, the market has moved to take advantage of current yield curve effects. The positively sloped yield curve provides the incentive to carry longer-term issues funded at short-term rates with less fear of capital losses. Indeed, some market observers feel the current inflation progress and oil price outlook might accommodate a cut in the discount rate, a factor which could produce capital gains for bond holders. Thus market sentiment, for the time being, has found a bullish niche.

As the Fed has focused on the monetary aggregate M3, which has a very stable and trendless velocity, monetary aggregates should not pose a problem for the Fed until mid-year (if then). Because first-quarter growth is in the bag and the second quarter will probably carry through with positive growth, there is no prospect of a need to lower rates to stimulate growth in the U.S. Oil price developments may permit one more discount rate cut, but it is likely that this cut would be all for quite a while. Thus the markets feel rather assured of economic developments through mid-year, and this makes the high longer-term yields more attractive, thus bringing long rates down. Barring unforeseen developments, a continuation of the trend to lower yields in the bond market is a good bet, even given the possibility of fits and starts in money market rates.

Robert A. Brusca

Irving Trust

Market Yields

	3/4/83 (Noon)	Week Ago	Year Ago
Prime Lending Rate at Irving Trust Company	10.50%	11.00%	16.50%
Effective since	2/28/83		
Discount Rate at Federal Reserve Bank	8.50	8.50	12.00
Federal Funds	8.38	8.13	14.50
Repurchase Agreements	8.38	8.05	14.70
U.S. Treasury Issues			
Bills			
3 months	8.21	8.13	12.75
6 months	8.39	8.29	13.35
1 year	8.59	8.58	13.48
Coupons			
2 years	9.28	9.28	13.85
4 years	9.64	9.72	13.75
7 years	10.13	10.19	13.65
10 years	10.26	10.25	13.55
Long Bond	10.44	10.47	13.30
Negotiable Certificates of Deposit-Secondary Market			
1 month	8.25	8.15	14.00
3 months	8.25	8.25	13.90
6 months	8.35	8.35	13.85
1 year	8.60	8.90	13.85
Banker's Acceptances			
1 month	8.25	8.10	13.85
3 months	8.25	8.20	13.90
6 months	8.35	8.35	13.85
Eurodollar Deposits			
1 month	8.75	8.88	14.38
2 months	8.75	8.94	14.38
3 months	8.75	8.94	14.38
Commercial Paper - Prime Names			
Directly placed by:			
Finance Companies			
1 week	8.51	8.12	13.72
1 month	8.42	8.17	13.97
3 months	8.13	8.28	13.76
Bank Holding Companies			
1 month	8.04	8.31	13.84
Dealer Placed:			
3 months	8.41	8.41	14.17
New AA Corporate Utility Bond	11.75	11.85	16.13
Tax Exempt			
6 month Project Notes	4.30	4.00	7.20
1 year AAA Bond	4.50	4.50	7.75
5 year AAA Bond	6.00	6.20	9.00
20 year AAA Bond	8.25	8.65	12.00

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Financial Markets

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**Economic Research &
Planning Division**

Friday
(Noon)

Mar. 11, 1983

By refocusing attention on fast growing money supply, Chairman Volcker dramatically altered the tone in the money markets this past week. In testimony before the House Budget Committee, Mr. Volcker admitted that M1 had been growing more rapidly than he had anticipated, causing the Fed to keep an eye on it. This is the first time since the Chairman's testimony before the Senate Banking Committee on February 16 that Mr. Volcker has pointed specifically to M1. Indeed, in his February 16 testimony, he downgraded the importance of M1 and highlighted that of M3. The money markets reacted to this change in emphasis.

Mr. Volcker's switch to being concerned over the growth of M1 is neither unexpected nor a change in policy. Still the switch has come sooner than most would have anticipated. At this time, the thrust of the Fed's concern remains in the background: M1's growth rate is too high to be sustained in the long run, but it is expected that M1 will behave itself within the next six months. So, in his typical way, Mr. Volcker has given us two sides of the story. Yet he has also given us news: that continued strong growth of M1 would lessen the prospects for lower interest rates, and that, should the economic recovery seem strong enough, the Fed might act more aggressively to stem a fast growing M1.

Such concerns are not immediate, however. This past week's Fed activities in the money market are one indication. The last statement week was a clear large drain week for bank reserves, yet the Fed did not go into the open market to do matched sales or outright sales of government securities to reduce bank reserves. The Fed drained reserves in a very passive way. Some of the drain was effected by the Treasury's increasing its balance held at the Fed. Some of it was done by the Fed's making securities sales (matched or outright) to its customers, central banks, and other official institutions. Their payment of "cash" to the Fed constitutes the drain. The opportunity for such securities sales undoubtedly was enhanced by tensions in the currency markets abroad. Frequently, when a member currency of the European Monetary System (EMS) strengthens too much it is sold in exchange for dollars to ease pressure on the weaker currencies in the EMS. The dollar balances from the sale of the strong currency accrue to the intervening central bank and may be available for investment in U.S. Treasury securities held at the Federal Reserve Bank of New York.

The Fed's generally passive draining of bank reserves has been a continuing theme for this year. It must be read as a signal that the Fed does not want any misinterpretation of its action; it is not tightening. What is more important, however, is the quantity of bank reserves the Fed makes available to the banking system. The method by which reserves are made available can transmit a signal, but let's not get carried away with nuance.

Robert A. Brusca

Irving Trust Market Yields

	3/11/83 (Noon)	Week Ago	Year Ago
Prime Lending Rate at Irving Trust Company	10.50%	10.50%	16.50%
Effective since	2/28/83		
Discount Rate at Federal Reserve Bank	8.50	8.50	12.00
Federal Funds	8.25	8.38	14.75
Repurchase Agreements	8.38	8.38	14.50
U.S. Treasury Issues			
Bills			
3 months	8.54	8.21	13.18
6 months	8.72	8.39	13.74
1 year	8.96	8.59	13.87
Coupons			
2 years	9.63	9.28	14.21
4 years	9.95	9.64	14.03
7 years	10.40	10.13	14.00
10 years	10.52	10.26	13.90
Long Bond	10.66	10.44	13.60
Negotiable Certificates of Deposit-Secondary Market			
1 month	8.55	8.25	14.20
3 months	8.65	8.25	14.40
6 months	8.70	8.35	14.50
1 year	9.15	8.60	14.70
Banker's Acceptances			
1 month	8.55	8.25	14.15
3 months	8.65	8.25	14.40
6 months	8.75	8.35	14.55
Eurodollar Deposits			
1 month	9.13	8.75	15.06
2 months	9.25	8.75	15.06
3 months	9.31	8.75	15.06
Commercial Paper - Prime Names			
Directly placed by:			
Finance Companies			
1 week	8.51	8.51	14.49
1 month	8.68	8.42	14.10
3 months	8.68	8.13	13.90
Bank Holding Companies			
1 month	8.30	8.04	13.58
Dealer Placed:			
3 months	8.66	8.41	14.72
New AA Corporate Utility Bond	11.90	11.75	16.25
Tax Exempt			
6 month Project Notes	4.40	4.30	7.75
1 year AAA Bond	4.75	4.50	8.00
5 year AAA Bond	6.00	6.00	9.20
20 year AAA Bond	8.50	8.25	11.95

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Financial Markets

Irving Trust

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Economic Research &
Planning Division

Friday
(Noon)

Mar. 18, 1983

Pressures built in the money and capital markets this week under the heavy burden of forthcoming Treasury debt offerings and a firmer rate for Federal funds. The auctions started off on a bad note with the usually popular two-year note auction going poorly, producing higher yields than expected. The lack of retail demand made many market participants wonder how the longer maturities, scheduled for auction next week, would sell. In this capital market environment, did the firmer rate for Federal funds hurt or help?

A stiffer rate for Federal funds hurts the prospect for a smooth functioning auction to the extent that RP and broker loan rates move in step with Fed funds. Higher dealer financing rates discourage dealers from bidding at the Treasury auctions and from carrying securities by reducing the positive spread of long yields over short rates. Indeed, to the extent that a higher rate for Federal funds is interpreted as a tightening by the Fed, the incentive to carry securities, and risk a price drop, greatly diminishes. But even if the higher rate for Fed funds is read as a slight tightening by the monetary authorities that doesn't necessarily impair the auction process.

For some time, dating back to November in certain cases, investors have been concerned about the too rapid money growth. To them, a firmer rate for Federal funds may be a signal that the Fed really is cautiously fighting inflation, in line with Mr. Volcker's statements of last week. To the extent that this is true, it would be a positive factor from a retail investor's standpoint. Thus dealers and investors might react differently to the same developments in the Fed funds market. What is the most likely interpretation of what the Fed is doing there?

First, the Fed does not control the funds rate perfectly. Nonetheless the funds rate has been kept in a very narrow range, indicating a strong Fed presence. Although the market has faced the possibility of some "technical" factors recently, with the passing of a corporate tax payment date, that cuts both ways. With a heavy schedule of Treasury auctions, one might have expected the Fed to err on the side of greater ease to encourage dealers to carry inventory from the auctions. But this has not happened. Thus it appears that the Fed is engineering the funds rate back to or above the level of the discount rate in an effort to gain somewhat better control over the funds rate. Such a rate configuration allows the Fed to use discount window policy to underpin the rate for Fed funds. Conversely when Fed funds trade below the discount rate, the Fed has less control; during such times, the market generally is looking for still lower rates, creating the danger that the market might become too liquid, leading rates to plunge. By moving the Fed funds rate above the discount rate, the Fed gains somewhat better technical control of the market and blunts expectations that the discount rate will soon be cut. Seen in this way, the Fed has not tightened policy; it has made a more consistent and possibly enduring pattern of market rates. Any new policy move at this point hinges on the developing recovery, which is too weak to provide scope for the Fed to truly tighten its policy.

Robert A. Brusca

Irving Trust

Market Yields

	3/18/83 (Noon)	Week Ago	Year Ago
Prime Lending Rate at Irving Trust Company	10.50%	10.50%	16.50%
Effective since	2/28/83		
Discount Rate at Federal Reserve Bank	8.50	8.50	12.00
Federal Funds	8.63	8.25	14.88
Repurchase Agreements	8.63	8.38	14.50
U.S. Treasury Issues			
Bills			
3 months	8.70	8.54	13.55
6 months	8.94	8.72	14.02
1 year	9.18	8.96	14.10
Coupons			
2 years	9.75	9.63	14.26
4 years	10.03	9.95	14.09
7 years	10.44	10.40	13.97
10 years	10.56	10.52	13.86
Long Bond	10.68	10.66	13.49
Negotiable Certificates of Deposit-Secondary Market			
1 month	8.70	8.55	14.40
3 months	8.80	8.65	14.50
6 months	9.00	8.70	14.55
1 year	9.20	9.15	14.55
Banker's Acceptances			
1 month	8.70	8.55	14.35
3 months	8.80	8.65	14.45
6 months	9.05	8.75	14.50
Eurodollar Deposits			
1 month	9.19	9.13	15.13
2 months	9.25	9.25	15.13
3 months	9.38	9.31	15.13
Commercial Paper - Prime Names			
Directly placed by:			
Finance Companies			
1 week	8.51	8.51	13.98
1 month	8.82	8.68	14.11
3 months	8.81	8.68	14.17
Bank Holding Companies			
1 month	8.30	8.30	14.37
Dealer Placed:			
3 months	8.80	8.66	14.99
New AA Corporate Utility Bond	11.95	11.90	16.13
Tax Exempt			
6 month Project Notes	4.60	4.40	7.50
1 year AAA Bond	5.10	4.75	8.00
5 year AAA Bond	6.00	6.00	9.25
20 year AAA Bond	8.50	8.50	12.10

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Financial Markets

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**Economic Research &
Planning Division**

Friday
(Noon)

Mar. 25, 1983

M1 is growing too fast, faster than Chairman Volcker would like, so he's going to keep an eye on it. It's growing faster than I would like, so I'm going to keep an eye on it, and on the Fed. For nearly three-quarters of a year, M1 has been growing steadily at a 15% annual rate. This is nearly three times the maximum rate M1 was supposed to be allowed to grow in 1982. The Fed is nowhere close to its target for M1 at this time; a target based well above the top of last year's goal with a generous allowance for further expansion. Shifts into the new Super NOW accounts, around only since early January of this year, offer an inadequate explanation for why M1 has grown with such vigor since September of last year. Yet I maintain that the Fed is not yet tightening and that current Fed policy is "correct." Why?

The Fed currently is confronted with a very difficult policy decision because of persisting exceptionally strong demands for M1 balances on the part of the public. Money supply growth has continued strong because the Fed has accommodated these demands. However, interest rates are high enough to put some distance between the Fed and accusations that it has been freely pumping out the money. In this regard, the recent higher trading range for Fed funds is an indication that the Fed is concerned about fast growing M1. But the Fed cannot do much more with interest rates; the economy is too weak. Raising interest rates (by draining bank reserves) would require an excessively sharp increase in rates if that move were intended to force M1 back inside its target range soon. Such an action would return M1 to its target range by deepening the recession rather than by encouraging people to hold fewer M1 balances through interest rate incentives. At this time, in fact, interest rates have a very small scope to rise. If domestic CD rates move much above 9%, certainly at the 9½% level, banks would be forced to raise their prime rates. Such an action would have a profound impact on market sentiment. As a result, the Fed funds rate is currently being held hostage between the discount rate at 8½% and a ceiling of about 9%.

M1 velocity usually picks up as GNP growth speeds; thus, as recovery develops, the Fed should gain scope to move M1 back toward its target range without pushing up rates. But right now, M1 velocity is a problem. Based on the Commerce Department's "flash" GNP estimate, M1's velocity shifted downward by about 7% in the first quarter of this year, continuing the recent bizarre behavior of money demand. The first-quarter decline in interest rates naturally contributes to this stronger demand for M1 balances (slower velocity). Also, the tendency for merchandisers to provide discounts for cash and for noncredit card purchases may increase the public's demand for M1 balances, especially in a low interest rate environment. Still, velocity should become somewhat more normal as this recovery unfolds.

The Fed can tolerate fast growing money for a while longer. As long as the Fed can be trusted to rein this growth in when velocity shifts back, there is no need for the public to fear inflationary effects. But Chairman Volcker does seem nervous about the fast growth. Looking ahead, with his term set to expire in August, he may not want to leave a legacy of fast money growth in the event that he should leave the chairmanship. But any move to tighten is still in the future.

Robert A. Brusca

Irving Trust

Market Yields

	3/25/83 (Noon)	Week Ago	Year Ago
Prime Lending Rate at Irving Trust Company	10.50%	10.50%	16.50%
Effective since	2/28/83		
Discount Rate at Federal Reserve Bank	8.50	8.50	12.00
Federal Funds	8.63	8.63	14.25
Repurchase Agreements	8.63	8.63	13.50
U.S. Treasury Issues			
Bills			
3 months	8.82	8.70	13.45
6 months	9.09	8.94	13.94
1 year	9.23	9.18	14.06
Coupons			
2 years	9.85	9.75	14.25
4 years	10.20	10.03	14.15
7 years	10.52	10.44	14.02
10 years	10.57	10.56	13.90
Long Bond	10.61	10.68	13.51
Negotiable Certificates of Deposit-Secondary Market			
1 month	8.85	8.70	14.15
3 months	9.00	8.80	14.40
6 months	9.15	9.00	14.50
1 year	9.45	9.20	14.60
Banker's Acceptances			
1 month	8.85	8.70	14.05
3 months	9.00	8.80	14.35
6 months	9.20	9.05	14.50
Eurodollar Deposits			
1 month	9.38	9.19	15.00
2 months	9.44	9.25	15.13
3 months	9.50	9.38	15.25
Commercial Paper - Prime Names			
Directly placed by:			
Finance Companies			
1 week	8.76	8.51	13.72
1 month	8.94	8.82	13.85
3 months	9.07	8.81	13.63
Bank Holding Companies			
1 month	8.56	8.30	13.72
Dealer Placed:			
3 months	8.98	8.80	14.44
New AA Corporate Utility Bond	12.10	11.95	16.13
Tax Exempt			
6 month Project Notes	4.70	4.60	8.20
1 year AAA Bond	4.85	5.10	8.10
5 year AAA Bond	6.40	6.00	9.50
20 year AAA Bond	8.75	8.50	12.00

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Financial Markets

Irving Trust

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**Economic Research &
Planning Division**

Friday
(Noon)

Apr. 1, 1983

Quarter-end is usually a time of increased pressures in the money markets; but this quarter has ended with somewhat greater tensions, even though these are not clearly evidenced by tighter-than-expected market conditions. For example, the Fed funds rate has behaved as it usually does at quarter-end: strong and volatile. Too many things have happened in too short a time period for the financial markets to confidently chart a course through the crosscurrents, however, and other rates have not changed much. Let's review some of the major changes that occurred just before quarter-end and see what is likely to re-emerge on the other side.

Foremost in the minds of market participants are the questions: Has the Fed tightened? Is the Fed tightening? Answers are elusive because the financial markets have been socked with a number of special events just before quarter-end. The Fed did move the funds rate up just before the Treasury mini-refunding. This is not a usual time for the Fed to tighten. Consequently the refunding was very uneasy. During the same period, the European Monetary System went through a realignment. Market sentiment on this event remains uncertain because the quarter-end factors and concern over the Fed have dominated the situation. Here, Treasury Secretary Regan has stepped up to offer the observation that he sees no reason why short-term interest rates should rise. The Europeans seemed to place faith in his words, by bidding down Eurodollar rates. But how will the U.S. markets react when quarter-end pressures are dissipated? How should we view these remarks?

Even as we weigh the Treasury Secretary's words, we are reminded of the statements of several key policymakers made just a few weeks ago: Chairman Volcker expressed the view that banks could lower some of their interest charges; President Reagan asserted that banks could lower the prime rate a notch or two. Banks obliged and lowered the prime rate a notch. The Fed responded in seemingly perverse fashion by raising the Fed funds rate on the heels of the prime-rate cuts. The timing is of interest here. The firmer funds rate occurred just after Chairman Volcker expressed concern over fast-growing M1. He expressed this concern just after the Shadow Open Market Committee met and criticized Fed monetary policy. This sequence of events is probably not coincidental. Notwithstanding the fact that monetarism seems to be taking a real drubbing in the press, for not offering a credible operational guideline, the Fed apparently seems concerned about possible future attacks from monetarists. This makes the Fed act a little monetarist, but only a little.

The unsettled condition of the money and capital markets requires moderation in Fed policy to accommodate economic recovery. Because money market rates are poised to move ahead of the funds rate, the Fed will likely act to rein funds in between the 8 3/4% to 9% range. At such a level for funds, CDs are unlikely to push too hard on the bank prime rate. If the Fed can stave off prime-rate increases for a while longer, the strong seasonal adjustment factors for M1 in April may suffice to damp its fast growth. Still, the next several weeks will be very jittery, with money market pressures more likely to be pressing rates up than down. The Fed will be tested.

Robert A. Brusca

Irving Trust

Market Yields

	4/1/83 (Noon)	Week Ago	Year Ago
Prime Lending Rate at Irving Trust Company	10.50%	10.50%	16.50%
Effective since	2/28/83		
Discount Rate at Federal Reserve Bank	8.50	8.50	12.00
Federal Funds	8.88	8.63	16.13
Repurchase Agreements	8.75	8.63	16.00
U.S. Treasury Issues			
Bills			
3 months	8.67	8.82	13.80
6 months	8.67	9.09	14.10
1 year	8.61	9.23	14.10
Coupons			
2 years	9.63	9.85	14.40
4 years	10.25	10.20	14.30
7 years	10.50	10.52	14.20
10 years	10.88	10.57	14.10
Long Bond	10.38	10.61	13.56
Negotiable Certificates of Deposit-Secondary Market			
1 month	9.00	8.85	14.70
3 months	9.10	9.00	14.65
6 months	9.15	9.15	14.55
1 year	9.50	9.45	14.55
Banker's Acceptances			
1 month	9.00	8.85	14.60
3 months	9.05	9.00	14.60
6 months	9.20	9.20	14.55
Eurodollar Deposits			
1 month	8.75	9.38	15.25
2 months	8.75	9.44	15.38
3 months	9.00	9.50	15.38
Commercial Paper - Prime Names			
Directly placed by:			
Finance Companies			
1 week	9.14	8.76	15.00
1 month	9.19	8.94	14.88
3 months	9.20	9.07	14.44
Bank Holding Companies			
1 month	8.68	8.56	14.10
Dealer Placed:			
3 months	8.81	8.98	15.15
New AA Corporate Utility Bond	12.15	12.10	16.50
Tax Exempt			
6 month Project Notes	5.00	4.70	8.20
1 year AAA Bond	5.25	4.85	8.30
5 year AAA Bond	6.50	6.40	9.50
20 year AAA Bond	8.75	8.75	12.10

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Financial Markets

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**Economic Research &
Planning Division**

Friday
(Noon)

Apr. 8, 1983

Last week the Fed released the minutes of the Federal Open Market Committee meeting of February 8-9. Market commentary on these minutes has focused on the fact that four of the voting FOMC members dissented from the adopted policy course set at that meeting. More importantly, the deliberations of that meeting set Fed policy at its most fundamental level: the target paths for the monetary aggregates in 1983. What insight can be gleaned from these minutes?

The dissent itself is not that newsworthy. Monetarist criticisms were to be expected from FOMC members who tend toward monetarism. (As of February, when the committee met, the rate of money growth had been very rapid.) The opposition of Mr. Black and Mrs. Horn reflected their desire to place more weight on the narrow monetary aggregate M1 instead of the broad aggregate M3. They tended to minimize any anomalies that could be associated with the behavior of M1, feeling instead that a fast-growing M1 was bound to be counterproductive if its growth wasn't stemmed soon. They also felt that M1 was more controllable than other aggregates. These are classical monetarist criticisms. No concern is registered over the possibility that the fledgling recovery might be jeopardized by tighter policy now. However, Mr. Black added that he was in favor of moving gradually to arrest money growth; but at the same time, he wished to have target ranges lower than those that were set (e.g., 4%-8% was adopted for M1).

Mr. Ford took the hardest and clearest line. Money, he argued, was growing too fast. He felt that the combination of fiscal and monetary policy was dangerous and could lead to a private-credit shortage in 1984 while aborting the recovery by producing high inflation and interest rates. Mr. Wallich did not address the current policy course but instead the parameters for this year's policy, holding that the money growth ranges for 1983 should be somewhat lower. He felt that lower ranges could accommodate recovery and minimize the risk of stimulating inflation.

None of these dissenters is a voting member of the FOMC now except Mr. Wallich. The others were changed in the usual March rotation of Federal Reserve District Bank presidents who sit on the FOMC and cast ballots. The net effect of this shift is to bring slightly less doctrinaire policymakers into the voting process. Mr. Corrigan, one of the new FOMC members, can be expected to be on the same wavelength as Mr. Volcker. They worked together at the New York Fed; then Mr. Corrigan followed Mr. Volcker to Washington on special assignment. Subsequently he took his current post in Minneapolis. Mr. Morris, from the Boston Fed, is a well known opponent of the strict monetarist approach. The other two presidents come from the Chicago and St. Louis Feds and are apt to have more monetarist leanings.

The change in personalities is important, and a moderate change in policy has accompanied their term. Mr. Volcker has already cast a wary eye at M1, and the downtrend in interest rates has been arrested--and replaced by an uptick. Neither the FOMC nor the Fed staff had anticipated a continued fast growth in M1 in February. At that time, they felt M1 would return to the target range, and the committee's majority felt that reduced reserve restraint would be acceptable. As this has not happened, the Fed is warily "leaning against" this unexpectedly rapid growth of M1. Interest rates remain firm.

Robert A. Brusca

Irving Trust

Market Yields

	4/8/83 (Noon)	Week Ago	Year Ago
Prime Lending Rate at Irving Trust Company	10.50%	10.50%	16.50%
Effective since	2/28/83		
Discount Rate at Federal Reserve Bank	8.50	8.50	12.00
Federal Funds	8.75	8.88	14.38
Repurchase Agreements	8.75	8.75	14.00
U.S. Treasury Issues			
Bills			
3 months	8.61	8.67	13.80
6 months	8.90	8.67	14.27
1 year	9.06	8.61	14.28
Coupons			
2 years	9.68	9.63	14.27
4 years	10.03	10.25	14.12
7 years	10.40	10.50	14.03
10 years	10.50	10.88	13.96
Long Bond	10.55	10.38	13.50
Negotiable Certificates of Deposit-Secondary Market			
1 month	8.80	9.00	14.70
3 months	8.80	9.10	14.70
6 months	8.95	9.15	14.70
1 year	9.30	9.50	14.80
Banker's Acceptances			
1 month	8.85	9.00	14.65
3 months	8.85	9.05	14.75
6 months	8.90	9.20	14.70
Eurodollar Deposits			
1 month	9.44	8.75	15.38
2 months	9.50	8.75	15.50
3 months	9.56	9.00	15.50
Commercial Paper - Prime Names			
Directly placed by:			
Finance Companies			
1 week	8.63	9.14	14.49
1 month	8.81	9.19	14.76
3 months	8.81	9.20	14.44
Bank Holding Companies			
1 month	8.81	8.68	14.10
Dealer Placed:			
3 months	8.97	8.81	NA
New AA Corporate Utility Bond	11.85	12.15	15.90
Tax Exempt			
6 month Project Notes	4.60	5.00	7.90
1 year AAA Bond	5.25	5.25	8.50
5 year AAA Bond	6.50	6.50	9.75
20 year AAA Bond	8.85	8.75	11.75

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Financial Markets

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**Economic Research &
Planning Division**

Friday
(Noon)

Apr. 15, 1983

Chairman Volcker testified before the House Banking Committee this week and seems to have said all the right things to calm the financial markets. At the same time, the Federal funds rate eased back from the 9% level it had flirted with; as a result, the mood in the domestic markets is quite a bit more bullish than it has been. For the time being, the stock market and bond market are not giving off conflicting signals. While such sympathetic movements are reassuring, they fall short of being guarantees.

Certainly the Volcker testimony was a focal point. The Chairman repeated that the money supply numbers were hard to read because of various distortions. He offered the observation that if he were setting loan rates at a bank, he would set them lower at this time. He also stated that interest rates were too high to allow a sustainable recovery to develop. Together, these statements were reassuring to the market. They indicate that the Chairman is concerned about the recovery and that interest rates are in some sense too high. The market has taken from this some direction, but is the expectation for too much too soon? What is the Fed likely to do?

The Fed appears to have put the funds rate above the discount rate before quarter-end. This was to acknowledge the fast growth of money. I don't think this readjustment is about to be reversed. But the markets seem to have pushed rates lower in response to the generally encouraging statements by the Chairman and because expectations are for some very good March and early April money supply numbers--across all the M's. The Fed has strengthened the seasonals on M1 so much that the usual April money bulge is likely to be gone. For example, applying this year's seasonal factors to last year's money supply lowers M1's growth in April of last year by a 10% annual rate compared with the statistics as originally released. The prospect for some good news on money supply has encouraged the long end of the market and dragged the short-term rates along for the ride.

Yet none of this means that the Fed is about to act quickly to lower the discount rate or to encourage cheaper Fed funds. The Fed wants the longer rates down but will probably remain constrained in what it does with the funds rate by the developments in money growth. Since seasonal adjustment procedures do not create or destroy money, the Fed will have to give us back more money growth in seasonal factors for other months to compensate for April. Indeed, the months immediately after April now have seasonal factors that will strengthen money growth beyond what was done by last year's adjustments. Money growth will likely be affected by the mid-year tax cut, which will bring late-year growth to the economy and spur money demand. The net result of these potential pressures is to keep the Fed wary of loosening rates now.

Although the long-term market may rally on the realization of good money supply numbers, short-dated certificates of deposit are already at so small a premium to Fed funds that they are almost certainly in for a correction. April may prove to be very difficult for the short-term market for this reason. Good money supply numbers can succeed in rallying the long end of the market, but only the Fed can move the short-dated instruments lower from current levels. I don't think the Fed will oblige.

Robert A. Brusca

Irving Trust

Market Yields

	4/15/83 (Noon)	Week Ago	Year Ago
Prime Lending Rate at Irving Trust Company	10.50%	10.50%	16.50%
Effective since	2/28/83		
Discount Rate at Federal Reserve Bank	8.50	8.50	12.00
Federal Funds	8.63	8.75	15.25
Repurchase Agreements	8.63	8.75	15.25
U.S. Treasury Issues			
Bills			
3 months	8.39	8.61	13.30
6 months	8.69	8.90	14.00
1 year	8.93	9.06	14.15
Coupons			
2 years	9.49	9.68	14.30
4 years	9.86	10.03	14.02
7 years	10.21	10.40	13.90
10 years	10.32	10.50	13.75
Long Bond	10.38	10.55	13.25
Negotiable Certificates of Deposit-Secondary Market			
1 month	8.55	8.80	14.75
3 months	8.55	8.80	14.65
6 months	8.70	8.95	14.60
1 year	9.10	9.30	14.60
Banker's Acceptances			
1 month	8.60	8.85	14.70
3 months	8.60	8.85	14.65
6 months	8.70	8.90	14.65
Eurodollar Deposits			
1 month	9.00	9.44	15.38
2 months	9.13	9.50	15.38
3 months	9.13	9.56	15.38
Commercial Paper - Prime Names			
Directly placed by:			
Finance Companies			
1 week	8.76	8.63	15.13
1 month	8.68	8.81	15.02
3 months	8.81	8.81	14.86
Bank Holding Companies			
1 month	8.68	8.81	14.10
Dealer Placed:			
3 months	8.78	8.97	15.26
New AA Corporate Utility Bond	11.65	11.85	16.13
Tax Exempt			
6 month Project Notes	4.60	4.60	8.10
1 year AAA Bond	4.75	5.25	8.00
5 year AAA Bond	6.50	6.50	9.25
20 year AAA Bond	8.25	8.85	11.70

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4/28/83

Financial Markets

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**Economic Research &
Planning Division**

Friday
(Noon)

Apr. 22, 1983

Release of the first official estimates of real gross national product growth and price inflation for the first quarter of 1983 provided market participants with a good opportunity to puzzle over the ambiguous. As it turns out, the economy is growing even less vigorously than had been expected. To make matters worse, the inflation rate stood at a 5.8% annual rate. These numbers should not be taken entirely at their face value, however, although they teach some valuable lessons. First, GNP growth was weak because government spending unexpectedly dropped in the first quarter, and this won't continue. Nevertheless, it does highlight the importance of the government in the recovery. Second, the implicit price deflator was affected by some technical problems in the first quarter. If we look instead at the chain price index (which uses a fixed basket of goods), we find the inflation rate at 3.5% per year, down from 5.1% last quarter. Still, unit labor costs continue to rise at about 6% per year. Thus what the GNP price deflators tell us is that inflation is being lowered, but is not licked. What kind of policy is being pursued in these circumstances?

Unfortunately we continue along a path that has been fraught with contradiction for nearly half a year. The pace of monetary expansion is too fast; interest rates remain too high; the budget deficits are too great; and the rate of economic growth is very sluggish--all at the same time. These circumstances did not develop overnight, nor will they be alleviated that quickly. The resulting policy tension stems from the fact that the Fed runs monetary policy (and has run it quite well, even if severely), while the Administration runs fiscal policy, and each is tugging in the opposite direction with an election year on the horizon.

So far, President Reagan has tacitly agreed with monetary policy as implemented. Chairman Volcker has been less congenial; he has criticized the Administration's large budget deficits and the policy of nonintervention on the exchange markets. His tight-fisted monetary policy would probably lead him to continued vigilance even into the election year--were he to retain his position.

Realizing that there are election-year pressures around the corner, Chairman Volcker is acting pre-emptively by presiding over a monetary policy that is almost too tight to permit recovery. Recovery, however, remains the top goal, although a weak one is quite acceptable, perhaps even desirable. A slow recovery flirts less with renewed inflation and will tend to move private-sector credit demands more slowly toward their possible collision with the prospective demands of the government. To ease this tension, Mr. Volcker has tried to "jawbone" down long rates, but so far this hasn't worked. Unless the money supply suddenly begins to cooperate, it appears that the Fed will hold interest rates somewhat tighter than even it would like. Next year, election-year pressures may bring somewhat easier policies.

Robert A. Brusca

Irving Trust

Market Yields

	4/22/83 (Noon)	Week Ago	Year Ago
Prime Lending Rate at Irving Trust Company	10.50%	10.50%	16.50%
Effective since	2/28/83		
Discount Rate at Federal Reserve Bank	8.50	8.50	12.00
Federal Funds	8.50	8.63	14.63
Repurchase Agreements	8.50	8.63	14.00
U.S. Treasury Issues			
Bills			
3 months	8.44	8.39	12.80
6 months	8.74	8.69	13.40
1 year	8.98	8.93	13.60
Coupons			
2 years	9.60	9.49	13.90
4 years	9.97	9.86	13.85
7 years	10.35	10.21	13.70
10 years	10.44	10.32	13.70
Long Bond	10.54	10.38	13.15
Negotiable Certificates of Deposit-Secondary Market			
1 month	8.50	8.55	14.20
3 months	8.55	8.55	14.20
6 months	8.75	8.70	14.15
1 year	9.15	9.10	14.20
Banker's Acceptances			
1 month	8.50	8.60	14.15
3 months	8.55	8.60	14.15
6 months	8.75	8.70	14.05
Eurodollar Deposits			
1 month	9.06	9.00	15.00
2 months	9.13	9.13	15.00
3 months	9.19	9.13	15.00
Commercial Paper - Prime Names			
Directly placed by:			
Finance Companies			
1 week	8.63	8.76	14.11
1 month	8.68	8.68	14.24
3 months	8.81	8.81	14.17
Bank Holding Companies			
1 month	8.30	8.68	14.10
Dealer Placed:			
3 months	8.54	8.78	14.86
New AA Corporate Utility Bond	11.65	11.65	15.80
Tax Exempt			
6 month Project Notes	5.20	4.60	7.60
1 year AAA Bond	5.25	4.75	7.50
5 year AAA Bond	6.40	6.50	9.10
20 year AAA Bond	8.60	8.25	11.60

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Financial Markets

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**Economic Research &
Planning Division**

Friday
(Noon)

Apr. 29, 1983

Once again the money markets are going through a period where technical factors dominate market rate movements. In the last calendar week, the Federal Reserve has done two repurchase transactions for the Federal Reserve's own account (System RPs). Some market participants have looked to this as a sign that the Fed is changing its policies and trying to move interest rates lower. But such is not the case this time. The System RPs may in fact be "aggressive" (large in size), but they are primarily "defensive"--they are intended to offset a drain of bank reserves rather than to inject new reserves.

April normally is a time when the Federal Reserve has to act somewhat aggressively to keep reserves from being drained from the banking system. During April the U.S. Treasury is receiving tax payments from the public, and these are the source of the problem. As the Treasury processes checks reflecting tax payments to it and as these "clear," the funds are transferred to the Treasury's account held at the Federal Reserve. The Treasury targets in-payments and out-payments through this account to maintain an average balance of about $3 billion. Payments to the Treasury that would push the balance of its account at the Fed above its target level are transferred to banks and must be collateralized with government securities to protect the value of the Treasury's deposits. This transfer keeps the reserves in the banking system. Were the Treasury just to run up its balance at the Fed, a drain in bank reserves would occur. If the drain were not offset by some other injection of reserves, upward pressure on the Fed funds rate would result.

The stipulation that Treasury deposits be collateralized causes banks to set limits on the volume of these deposits that they will accept. As a result, in April, these Treasury accounts become filled to capacity and lead to an increase in Treasury deposits at the Fed, thus draining reserves. To offset this drain, the Fed has very few options. First, if the Fed had done a large volume of internal matched sales with its customers (primarily foreign central banks) the previous week, it could let these run off, thereby resupplying reserves to the banking system; and it would refuse to do any more matched sales with customer accounts. This would mean passing through to the market all customer orders (customer RPs). However, it is unlikely that the Fed would be able to match precisely its open market reserve needs with the investment desires of its customers. Second, the Fed could do an outright purchase of securities with the market and inject reserves, but this activity is usually reserved for "permanent" reserve injection. Third, the Fed could sell dollars and buy foreign exchange as many foreign countries do; but this action is almost never undertaken for reserve management purposes in the U.S. Thus the Fed is left to do System RPs. One danger of this is that the market often views actions for the System's own account as more aggressive and therefore as a clue as to where interest rates are going. At this time, however, the System RPs are accompanied by a high level for Fed funds, near 9%. The rising rate for Fed funds clearly indicates that the Fed is not pushing interest rates down. The System RPs are purely technical.

Robert A. Brusca

Irving Trust

Market Yields

	4/29/83 (Noon)	Week Ago	Year Ago
Prime Lending Rate at Irving Trust Company	10.50%	10.50%	16.50%
Effective since	2/28/83		
Discount Rate at Federal Reserve Bank	8.50	8.50	12.00
Federal Funds	8.75	8.50	15.25
Repurchase Agreements	8.50	8.50	12.63
U.S. Treasury Issues			
Bills			
3 months	8.30	8.44	12.82
6 months	8.56	8.74	13.45
1 year	8.71	8.98	13.57
Coupons			
2 years	9.36	9.60	13.93
4 years	9.74	9.97	13.90
7 years	10.14	10.35	13.83
10 years	10.27	10.44	13.83
Long Bond	10.38	10.54	13.35
Negotiable Certificates of Deposit-Secondary Market			
1 month	8.30	8.50	14.15
3 months	8.35	8.55	14.15
6 months	8.45	8.75	14.15
1 year	8.90	9.15	14.15
Banker's Acceptances			
1 month	8.46	8.50	14.10
3 months	8.43	8.55	14.10
6 months	8.55	8.75	14.20
Eurodollar Deposits			
1 month	8.81	9.06	15.06
2 months	8.88	9.13	15.00
3 months	8.88	9.19	14.94
Commercial Paper - Prime Names			
Directly placed by:			
Finance Companies			
1 week	8.63	8.63	13.98
1 month	8.56	8.68	14.50
3 months	8.54	8.81	14.31
Bank Holding Companies			
1 month	8.17	8.30	14.10
Dealer Placed:			
3 months	8.56	8.54	14.66
New AA Corporate Utility Bond	11.60	11.65	16.13
Tax Exempt			
6 month Project Notes	4.80	5.20	7.50
1 year AAA Bond	4.75	5.25	7.25
5 year AAA Bond	6.30	6.40	8.75
20 year AAA Bond	8.20	8.60	10.80

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5/12/83

Financial Markets

Irving Trust

Irving Trust Company
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**Economic Research &
Planning Division**

Friday
(Noon)

May 6, 1983

Over the last two weeks, market participants have become transfixed by the possibility that interest rates might really make a significant move to lower levels. The change in mood has been triggered by some steady declines in M1, the narrowest monetary aggregate, and indications that the broader aggregates, M2 and M3, might show very sluggish growth in April. Some have begun to talk of the prospect that the Fed might even cut the discount rate soon. Cutting the discount rate would be an act of pure discretion at this time: The Fed is not being pressured by events or by the Administration to lower rates now. It therefore seems more likely to me that rates will hold at current levels and that a backup might even occur.

The economy is not crying out for further stimulus at this time and does not provide a reason to lower rates. Perhaps it is surprising, but housing starts are holding up well, even at current interest rates. Auto sales are picking up, albeit with interest rate subsidies. The prospect of substantial government deficit spending underpins notions that real GNP will continue to move forward this year. And, further stimulus will come with the mid-year tax cut.

Further stimulus at this time might trigger inflation. In any event, as this recovery builds, prices will rise despite the strong dollar and low oil prices. The President's program to support agricultural prices will add to inflation. By year-end, we might be seeing some inflation statistics considerably worse than the recent ones. The Fed is probably crafting policy now to anticipate that possibility.

The "prospect" of lower monetary growth is an illusory lure to lower rates. Everyone has known that April would bring the strongest seasonals ever to damp money growth --and the job has been done. But what about after April and the seasonal revisions that will strengthen money growth? Surely the Fed would prefer to wait and see if April money is a seasonal or a fundamental phenomenon.

If we look further ahead there are other reasons to see why the Fed should wait to lower rates. It is a bit hard to imagine that a cut in interest rates soon could sustain a declining trend through the presidential elections in 1984. Yet it is also hard to foresee the Fed raising rates in the teeth of a presidential election campaign, with unemployment still very high. More logically, interest rates should be expected to remain firm until late this year or early next, when both the political and economic cycles will be calling for a shot in the arm for the economy.

Were the Fed to lower rates soon, it's very possible that long rates might even back up as they did early in the year. Furthermore, the progress on the long end of the rate structure makes further Fed action unnecessary for now. But the short rates have clearly run ahead in search of a discount rate cut. Some of this can be explained by "supply" problems. Banks, flush with MMDA funds, have reduced their CDs outstanding from $141 billion in early December to $104 billion. Commercial paper is down from $173 billion to $167 billion over the same period. Thus, the scarcity of open market paper has played a role in reducing yields, narrowing spreads against short-term Treasury issues, and flattening the yield curve. CDs can't continue to trade below the funds rate, however, unless expectations of a discount rate cut persist. These expectations could erode over the coming weeks, and short-term rates move back up. Optimism should be tempered with caution at this time.

Robert A. Brusca

Irving Trust

Market Yields

	5/6/83 (Noon)	Week Ago	Year Ago
Prime Lending Rate at Irving Trust Company	10.50%	10.50%	16.50%
Effective since	2/28/83		
Discount Rate at Federal Reserve Bank	8.50	8.50	12.00
Federal Funds	8.38	8.75	14.88
Repurchase Agreements	8.38	8.50	14.50
U.S. Treasury Issues			
Bills			
3 months	8.30	8.30	12.80
6 months	8.43	8.56	13.24
1 year	8.59	8.71	13.30
Coupons			
2 years	9.23	9.36	13.66
4 years	9.63	9.74	13.64
7 years	10.08	10.14	13.58
10 years	10.16	10.27	13.48
Long Bond	10.30	10.38	13.09
Negotiable Certificates of Deposit-Secondary Market			
1 month	8.30	8.30	14.20
3 months	8.35	8.35	13.75
6 months	8.30	8.45	13.60
1 year	8.70	8.90	13.50
Banker's Acceptances			
1 month	8.31	8.46	14.20
3 months	8.33	8.43	13.70
6 months	8.39	8.55	13.50
Eurodollar Deposits			
1 month	8.69	8.81	14.88
2 months	8.75	8.88	14.63
3 months	8.75	8.88	14.44
Commercial Paper - Prime Names			
Directly placed by:			
Finance Companies			
1 week	8.51	8.63	14.62
1 month	8.42	8.56	14.24
3 months	8.41	8.54	13.89
Bank Holding Companies			
1 month	8.17	8.17	14.10
Dealer Placed:			
3 months	8.44	8.56	14.17
New AA Corporate Utility Bond	10.88	11.60	15.75
Tax Exempt			
6 month Project Notes	4.70	4.80	7.40
1 year AAA Bond	5.00	4.75	7.50
5 year AAA Bond	6.30	6.30	9.25
20 year AAA Bond	8.30	8.20	11.60

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Financial Markets

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Economic Research &
Planning Division

Friday
(Noon)

May 13, 1983

Recent headlines have begun to focus on international events and the prospect that international conditions might provide some insight into the future course of U.S. monetary policy. The Organization for Economic Cooperation and Development (OECD) just concluded a ministerial meeting that surely has laid the groundwork for the approach to be taken and the issues to be discussed at the upcoming Williamsburg economic summit. In a separate meeting, also held this week--involving officials from GATT (General Agreement on Tariffs and Trade), the OECD, the IMF, and trade ministers from several major industrialized countries--the case for freer world trade was pleaded. What do these events mean for U.S. policy?

At the OECD meeting, the member governments pledged themselves to: gear policies for growth and job creation; reverse protectionist trends; resolve the debt crisis through trade expansion; and help poorer developing countries. Concern that protectionist sentiment is spreading and that it must be stopped is reassuring. The danger posed by protectionism is real. But there are no concrete plans for action. Calls for less protectionism are always on the lips of internationalists. Less protection is the great "free lunch" on the international menu. By resisting protectionism we can better reap the gains from trade: more output, greater employment, and lower prices. This was the easy agreement, in principle. Less reassuring is the notion that dismantling protectionist tendencies will solve the LDC debt problem. Protectionism is really a political hot potato among more developed nations. Trade expansion will help LDCs over the long haul but will do little in the near term.

The OECD communique also addressed interest rates and monetary policy: Interest rates should be allowed to move lower; monetary growth targets should not be lowered in response to lower oil prices; monetary policy should not accommodate inflationary pressures; and structural budget deficits should be reduced. There is certainly language here to please everyone! The policy prescription pointed selected countries in certain directions. Yet it is unclear whether any change in policy will be forthcoming.

In the U.S. some have concluded that the Fed will cut the discount rate ahead of the Williamsburg summit. This, however, is unlikely. To achieve this result, the Administration would have to strike a deal with the Fed. Furthermore, the U.S. would surely hold a discount rate cut as a bargaining position for use during the summit meeting--if it were willing to cut rates at all. Moreover, it must be remembered that these summit meetings rarely produce substance. Why should this one be different? At best we should expect the summit conference to produce a "spirit of cooperation" to contrast with the Versailles summit. Ironically, an actual change in policy may not be necessary at Williamsburg to please the participants. Already, signs of the much desired growth are emerging in the U.S. and abroad. The timing of the meeting just might prove to be fortuitous for the participants. A change in U.S. policy remains as an unlikely possibility. Yet an agreement on international cooperation and coordination of policy will surely be reached.

Robert A. Brusca

Irving Trust

Market Yields

	5/13/83(Noon)	Week Ago	Year Ago
Prime Lending Rate at Irving Trust Company	10.50%	10.50%	16.50%
Effective since	2/28/83		
Discount Rate at Federal Reserve Bank	8.50	8.50	12.00
Federal Funds	8.25	8.38	14.50
Repurchase Agreements	8.25	8.38	14.25
U.S. Treasury Issues			
Bills			
3 months	8.30	8.30	12.90
6 months	8.49	8.43	13.36
1 year	8.69	8.59	13.47
Coupons			
2 years	9.28	9.23	13.78
4 years	9.68	9.63	13.79
7 years	10.11	10.08	13.65
10 years	10.20	10.16	13.51
Long Bond	10.36	10.30	13.16
Negotiable Certificates of Deposit-Secondary Market			
1 month	8.25	8.30	14.20
3 months	8.30	8.35	13.90
6 months	8.45	8.30	13.85
1 year	8.80	8.70	13.75
Banker's Acceptances			
1 month	8.26	8.31	14.15
3 months	8.37	8.33	13.80
6 months	8.46	8.39	13.80
Eurodollar Deposits			
1 month	8.69	8.69	15.06
2 months	8.75	8.75	14.81
3 months	8.81	8.75	14.63
Commercial Paper - Prime Names			
Directly placed by:			
Finance Companies			
1 week	8.26	8.51	14.37
1 month	8.42	8.42	14.24
3 months	8.41	8.41	13.89
Bank Holding Companies			
1 month	7.97	8.17	13.84
Dealer Placed:			
3 months	8.41	8.44	14.85
New AA Corporate Utility Bond	11.30	11.30	15.95
Tax Exempt			
6 month Project Notes	4.75	4.70	7.55
1 year AAA Bond	5.00	5.00	7.30
5 year AAA Bond	6.50	6.30	8.75
20 year AAA Bond	8.15	8.30	11.50

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6/27/83

Financial Markets

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**Economic Research &
Planning Division**

Friday
(Noon)

May 20, 1983

The money and credit markets were jolted this past week by a much larger than expected increase in M1 accompanied also by stronger growth for M2 and M3 than the market had projected. Amid news that the economy was strengthening faster than anticipated, the money supply results disappointed a market that simply had gotten too far ahead of itself. As a result, the market is no longer "priced" for a Fed discount rate cut. What happens next?

Despite the relatively sharp movements in the price of money market instruments this past week, prospects for the rest of the year are for rather small changes in interest rates--particularly in comparison with what we have experienced over the past several years. The Fed will continue to let its policy be conditioned by the needs of the real economy even over the protestations of any particular monetary aggregate. In this regard Governor Preston Martin's statement clearly was intended to remove M1 from the close scrutiny to which the market has subjected it. (Governor Martin indicated that M1 was still affected by certain distortions making it unreliable.) Still, the Fed is not completely disregarding its monetary targets; it's just that these are entering into the policy picture in a much more complex way.

The Fed is being less monetarist because very monetarist procedures have yet to prove that they can foster recovery. Market participants clearly realize this. Indeed, this is why Chairman Volcker's statement that the economy seems to have more momentum than before is so damaging to market sentiment. An application of Newtonian economics (an economy in motion tends to stay in motion...) by the Chairman underscores the position that the economy needs no stimulation from an outside source (like interest rates) as long as it is moving ahead.

For now, M1 above target--due to a combination of errant seasonal factors and a continued lag in velocity growth--provides the Fed with ample cause to hold interest rates steady. But what if M1 should move inside its target? Would the Fed cut rates? Here, two cases can be isolated. In the first case, with a flagging economy, a fall in money growth would most likely be viewed as the result of a collapse in money demand that should be reacted to with lower rates. In the second case, with a strong economy, the Fed would likely not react with a cut in rates. With economic growth progressing, the Fed would be more likely to think in terms of velocity and turn its attention to the prospect that if velocity grows, the 1983 targets begin to look very generous instead of confining. Thus, the Fed would "desire" M1 at the target bottom and would likely resist interest rate cuts until M1 was well in hand, and supported by an M3 within target.

According to these scenarios, we only get a sharp Fed-led break in rates if the economy suddenly goes flat. Still, market participants will continue to be anxious and to look for opportunity. As we have seen in recent weeks, the markets can produce a fairly wide trading range even without outward signals from the Fed. This situation will persist over the coming months, until the Fed decides which way it must move rates: The Fed is following the economy and, less closely, the money supply; it's not leading anymore.

Robert A. Brusca

Irving Trust

Market Yields

	5/20/83 (Noon)	Week Ago	Year Ago
Prime Lending Rate at Irving Trust Company	10.50%	10.50%	16.50%
Effective since	2/28/83		
Discount Rate at Federal Reserve Bank	8.50	8.50	12.00
Federal Funds	8.63	8.25	13.50
Repurchase Agreements	8.50	8.25	11.75
U.S. Treasury Issues			
Bills			
3 months	8.43	8.30	11.90
6 months	8.70	8.49	12.39
1 year	8.96	8.69	12.79
Coupons			
2 years	9.58	9.28	13.47
4 years	9.98	9.68	13.59
7 years	10.39	10.11	13.56
10 years	10.48	10.20	13.48
Long Bond	10.64	10.36	13.14
Negotiable Certificates of Deposit-Secondary Market			
1 month	8.55	8.25	13.45
3 months	8.60	8.30	13.30
6 months	8.75	8.45	13.30
1 year	9.15	8.80	13.30
Banker's Acceptances			
1 month	8.46	8.26	13.40
3 months	8.63	8.37	13.30
6 months	8.79	8.46	13.25
Eurodollar Deposits			
1 month	8.94	8.69	14.50
2 months	9.00	8.75	14.44
3 months	9.13	8.81	14.38
Commercial Paper - Prime Names			
Directly placed by:			
Finance Companies			
1 week	8.51	8.26	12.20
1 month	8.56	8.42	13.07
3 months	8.68	8.41	13.35
Bank Holding Companies			
1 month	8.56	7.97	13.32
Dealer Placed:			
3 months	8.66	8.41	14.17
New AA Corporate Utility Bond	11.40	11.30	15.85
Tax Exempt			
6 month Project Notes	4.75	4.75	7.50
1 year AAA Bond	5.25	5.00	7.75
5 year AAA Bond	6.60	6.50	9.00
20 year AAA Bond	8.50	8.15	11.80

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Financial Markets

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**Economic Research &
Planning Division**

Friday
(Noon)

May 27, 1983

If the financial markets were jolted by the money supply number released two weeks ago, they were stunned by last week's $7.1 billion increase. Surging M1 growth is widely believed to be the result of later-than-usual tax refunds, languishing as deposits in the transactions components of the monetary aggregates. This has prompted some criticism of the Fed's (faulty) seasonal factors, a view that is appealing, but not reassuring. April's strong seasonal factors were designed to flatten the "usual" April money bulge. If instead it's true that the real surge in money is coming later this year, it's also true that April's seasonals were too strong--this in turn means that, properly adjusted, money growth should have been measured as even stronger in April. This is why the "faulty seasonal" argument does not satisfy. How strong is true money growth? Does the Fed care?

Nothing that I am aware of can explain away the strength of money growth. Arguments based on faulty seasonals suffice (by definition) to bring M1 inside the growth range, but only for the time being. Consistency requires the substitution of stronger (growth-raising) seasonals later in the year. It is this aspect of seasonality that must not be forgotten: Seasonality neither creates nor destroys money--it just redistributes. Therefore, it appears to me that the Fed is facing a fundamental problem in money demand, not some technical aberration.

The theoretical problem, to an economist, concerns the recent behavior of the money demand function. This is a statistical relationship that describes the money balances held by the public in terms of income, interest rates, and, sometimes, other factors. If this relationship has undergone some permanent shift, the Fed will (and should) miss its monetary targets this year. On the other hand, money demand relationships are notorious for their short-term instabilities; if the current shift (instability) in money demand is temporary, the Fed will have to counterbalance its current money-pumping operation when money demand shifts back. The current debate among economists thus can be seen as choosing sides on the temporary-permanent issue. The good news is that this debate can be settled. The bad news is that it will be settled by economic historians!

The FOMC has no such luxury. It must make policy today. The committee's recognition of the money demand problem is reflected in statements concerning the velocity of M1 (this is just another way to summarize the money demand problem). In spite of the erratic behavior in M1's velocity, the Fed will, in all likelihood, stick with M1 and an M1 target. This is the aggregate closest to the concept of money that economists ponder on chalkboards. Unless the Board of Governors' staff can isolate reasons for M1's strong growth, the intellectual attachment to M1 will probably carry the day and lead the Fed to react to M1 at some point. For now, the Fed is looking straight through its intermediate targets (M1, M2, M3) to focus on the economy. But as the strength of economic recovery is realized, the Fed will come to look more and more closely at all its intermediate targets, including M1. The pragmatic policy that has characterized the Fed so far this year will be tested by criticism from the usual core of monetarists; their ranks will swell as the money growth problem endures or worsens.

Robert A. Brusca

Irving Trust

Market Yields

	5/27/83 (Noon)	Week Ago	Year Ago
Prime Lending Rate at Irving Trust Company	10.50%	10.50%	16.50%
Effective since	2/28/83		
Discount Rate at Federal Reserve Bank	8.50	8.50	12.00
Federal Funds	8.50	8.63	13.38
Repurchase Agreements	8.13	8.50	11.88
U.S. Treasury Issues			
Bills			
3 months	8.74	8.43	12.00
6 months	9.01	8.70	12.52
1 year	9.23	8.96	12.89
Coupons			
2 years	9.86	9.58	13.71
4 years	10.18	9.98	13.76
7 years	10.54	10.39	13.81
10 years	10.58	10.48	13.67
Long Bond	10.74	10.64	13.33
Negotiable Certificates of Deposit-Secondary Market			
1 month	8.65	8.55	13.38
3 months	8.80	8.60	13.38
6 months	9.10	8.75	13.50
1 year	9.40	9.15	13.50
Banker's Acceptances			
1 month	8.66	8.46	13.25
3 months	8.85	8.63	13.35
6 months	9.10	8.79	13.60
Eurodollar Deposits			
1 month	9.06	8.94	14.25
2 months	9.13	9.00	14.38
3 months	9.25	9.13	14.50
Commercial Paper - Prime Names			
Directly placed by:			
Finance Companies			
1 week	8.63	8.51	13.21
1 month	8.68	8.56	13.58
3 months	8.81	8.68	13.62
Bank Holding Companies			
1 month	8.30	8.56	13.20
Dealer Placed:			
3 months	8.89	8.66	14.04
New AA Corporate Utility Bond	11.65	11.40	15.95
Tax Exempt			
6 month Project Notes	4.75	4.75	7.40
1 year AAA Bond	5.50	5.25	7.75
5 year AAA Bond	7.00	6.60	9.00
20 year AAA Bond	9.10	8.50	11.50

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Financial Markets

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**Economic Research &
Planning Division**

Friday
(Noon)

June 3, 1983

The prices of financial market instruments took another drubbing following release of the money supply number last Friday. While money supply was up--again--the real culprit this time seems to have been the minutes released for the March 28-29 FOMC meeting. Deliberations at that meeting seemed to focus policy more closely on M1 because the meeting produced a short-term target for M1, benchmarked from a base in March to an end in June. The market's adverse reaction to this revelation does not simply owe to the fact that a target was set, but also to the fact that M1 is now way over the top of that target. The worry is that the Fed might tighten, and soon.

The response of the markets was very rational. However, certain (unnamed) FOMC members subsequently were cited in the press as saying the Fed had not agreed to tighten, at least not yet. There does appear to be a split within the FOMC, and it is not clear what policy is in force. At present, the Fed can run almost any policy it wants based on its own assessments and prescriptions for action. The Fed could toss out M1 as a target on grounds of (continued) bizarre velocity performance. But, if this were done, could the other targets still be taken as "serious" or would the markets come to feel that the Fed would discard any intermediate target that stood in the way of the Fed's true intermediate target? (Presumably, that would be interest rates, without being precise about which ones.)

Although feasible, I think it would be difficult for the Fed to step away from its M1 target. Indeed the setting of a short-run target underscores the Fed's attempt to rejuvenate M1 in some form. In March, that short-run growth target of 6%-7% would have seemed quite attainable. M1 for the month had been boosted to a huge $497.6 billion, although this precise figure was not yet known at the time of the meeting. Thus, with strong growth-damping seasonals coming in April, the June target must have seemed reachable. Besides, the target itself was not stringent; if it were extrapolated to the end of the year, it would not even bring M1 inside the annual growth range set in February. Yet it now seems implausible that the Fed can reach the short-run target in June.

The Fed missed its M1 target in 1982. For 1983, it set a high base and very generous upper growth bound. To now have set and missed a short-run target that allows even greater growth through mid-year looks very bad. All of this indicates how much less monetarist the Fed has become. The market's concern is also over the protracted period of rapid M1 growth. Over the last year, M1 has speeded ahead at nearly a 12% annual rate; faster over more recent periods. The Fed may cease to have credibility if it sets yet another target for M1. Moreover, retreat to the broader aggregates now seems to promise less leeway for action than it did earlier. Yet the Fed's policies have been couched in terms of the monetary aggregates and the use of nonborrowed reserves for so long, it's doubtful that the Fed can change this course. Therefore, a compelling case can be made for the Fed's being forced to tighten. In addition, the strength of the economy is an important factor. It does seem to provide the scope for the Fed to move. While money growth can be fickle, at least a modest tightening before too long seems inevitable.

Robert A. Brusca

Irving Trust

Market Yields

	6/3/83 (Noon)	Week Ago	Year Ago
Prime Lending Rate at Irving Trust Company	10.50%	10.50%	16.50%
Effective since	2/28/83		
Discount Rate at Federal Reserve Bank	8.50	8.50	12.00
Federal Funds	8.63	8.50	13.50
Repurchase Agreements	8.63	8.13	13.50
U.S. Treasury Issues			
Bills			
3 months	8.84	8.74	12.64
6 months	9.20	9.01	13.05
1 year	9.39	9.23	13.45
Coupons			
2 years	10.02	9.86	13.95
4 years	10.38	10.18	13.95
7 years	10.74	10.54	14.00
10 years	10.78	10.58	13.90
Long Bond	10.92	10.74	13.70
Negotiable Certificates of Deposit-Secondary Market			
1 month	8.80	8.65	13.65
3 months	8.95	8.80	13.85
6 months	9.20	9.10	13.90
1 year	9.55	9.40	14.00
Banker's Acceptances			
1 month	8.87	8.66	13.55
3 months	9.00	8.85	13.75
6 months	9.16	9.10	13.90
Eurodollar Deposits			
1 month	9.13	9.06	14.25
2 months	9.25	9.13	14.63
3 months	9.38	9.25	14.69
Commercial Paper - Prime Names			
Directly placed by:			
Finance Companies			
1 week	8.76	8.63	13.60
1 month	8.94	8.68	13.72
3 months	9.07	8.81	13.89
Bank Holding Companies			
1 month	8.81	8.30	13.58
Dealer Placed:			
3 months	9.04	8.89	13.89
New AA Corporate Utility Bond	11.70	11.65	16.30
Tax Exempt			
6 month Project Notes	4.95	4.75	7.60
1 year AAA Bond	5.50	5.50	7.75
5 year AAA Bond	7.00	7.00	9.00
20 year AAA Bond	9.50	9.10	11.40

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Financial Markets

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Economic Research &
Planning Division

Friday
(Noon)

June 10, 1983

Over the past four weeks, the money and capital markets have undergone a substantial backup. Yields on three-month CDs have risen by about 100 basis points, while the yield on the government long bond has moved up by 55 basis points. Over this same period, the effective rate for Fed funds (a rate weighted by the volume of transactions at each level) has risen by 35 basis points. On the face of it, these statistics do not give strong support to the notion that the Fed is tightening policy--money market rates have zoomed up far faster than the funds rate. But then why have rates firmed? Has the Fed been responsible?

To a great extent the market has put rates up in advance of strong action by the Fed. Yet this does not mean that the Fed is not responsible or that the rise in rates is undesired. Market participants have come to see the overly rapid growth of M1 as something the Fed is unlikely to ignore. Thus they have acted in anticipation of Fed reaction. But this situation is not clear cut--a number of Fed officials have been quoted recently saying conflicting things about the importance of M1.

Perhaps the clearest sign of Fed intentions occurred on Wednesday, June 1. On that last day of the reserve maintenance period, the Fed executed a System RP, adding reserves to the banking system, thereby alleviating some pressure on the Fed funds rate. Occurring on Wednesday, as it did, the transaction indicates a rate preference by the Fed. Late in the statement week, the Fed has very accurate reserve projections and can be fairly sure of the banking system's reserve position. However, one unexpected development was the large holding by banks of excess reserves, $5.4 billion on Wednesday. The Fed did not know about this at the time; all it could see was the rate pressure. Rate pressure emerged because the excess reserves held at some banks were unavailable for use at banks that were reserve deficient. The RP accommodated the demand for excess reserves by the banking system by allowing reserve deficient banks to purchase reserves in the market rather than forcing borrowing from the Fed. The decision to trade off nonborrowed reserve path goals for interest rate goals is notable.

The accommodative posture by the Fed would seem to indicate a Fed policy more attuned to interest rates than to a nonborrowed reserve path--at least at some level of rates. The Fed executed the RP with Fed funds at 9 3/8%, making it seem as though the Fed was protecting the 9 1/2% level. Thus the Fed seems willing to allow Fed funds to trade somewhat above 9% without reaction--this is a definite change from the general 8 1/2%-8 3/4% range that had existed. Still, the market is concerned that these rates could go higher. Indeed, if the Fed really wishes to tighten--to gain control of M1--rates must be pushed up far higher. This is something I don't think the Fed will do. However, it will keep rates on the firm side as long as money growth is a problem. An added element is that M2 and M3 are going to look a little worse to the Fed than they have so far this year. The Fed's room to maneuver, therefore, is being restricted, and the market clearly perceives that.

Robert A. Brusca

Irving Trust

Market Yields

	6/10/83 (Noon)	Week Ago	Year Ago
Prime Lending Rate at Irving Trust Company	10.50%	10.50%	16.50%
Effective since	2/28/83		
Discount Rate at Federal Reserve Bank	8.50	8.50	12.00
Federal Funds	8.75	8.63	14.25
Repurchase Agreements	8.63	8.63	13.63
U.S. Treasury Issues			
Bills			
3 months	9.04	8.84	12.40
6 months	9.36	9.20	13.08
1 year	9.59	9.39	13.50
Coupons			
2 years	10.10	10.02	13.80
4 years	10.45	10.38	14.01
7 years	10.80	10.74	14.10
10 years	10.83	10.78	13.90
Long Bond	10.92	10.92	13.82
Negotiable Certificates of Deposit-Secondary Market			
1 month	9.00	8.80	13.70
3 months	9.25	8.95	13.80
6 months	9.50	9.20	14.05
1 year	9.95	9.55	14.15
Banker's Acceptances			
1 month	9.05	8.87	13.90
3 months	9.30	9.00	13.90
6 months	9.50	9.16	14.10
Eurodollar Deposits			
1 month	9.38	9.13	14.38
2 months	9.50	9.25	14.63
3 months	9.63	9.38	14.88
Commercial Paper - Prime Names			
Directly placed by:			
Finance Companies			
1 week	8.89	8.76	13.86
1 month	9.19	8.94	13.84
3 months	9.34	9.07	13.89
Bank Holding Companies			
1 month	9.07	8.81	13.58
Dealer Placed:			
3 months	9.39	9.04	13.89
New AA Corporate Utility Bond	11.80	11.70	16.35
Tax Exempt			
6 month Project Notes	4.95	4.95	7.80
1 year AAA Bond	5.55	5.50	8.15
5 year AAA Bond	7.00	7.00	9.50
20 year AAA Bond	9.50	9.50	11.75

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Financial Markets

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**Economic Research &
Planning Division**

Friday
(Noon)

June 17, 1983

Just when you were getting tired of everyone harping about how badly M1 has performed relative to its target, another of the Fed's aggregates is threatening to become a problem: M3. Now don't jump to the conclusion that M1 is all right, it's not. But do realize that if the Fed were looking for excuses to tighten its credit policy, it would have two monetary aggregates that could support such a move. The current level for M1 is scary; it's about what it should be on Halloween (October). M3 is not so disoriented. Yet it is at the top of its target, and, given what M1 is doing, M3 at the top of its target is harder to ignore.

M3 is not a new ingredient in the recipe for good monetary policy, but it's one that has taken on a sharper taste. Through most of this year, the Fed has tried to convince the financial markets that the broader aggregates, M2 and M3, are going to be a better guide to policy. However, the M2 target is an odd construction, and M3 has hovered in the upper portion of its target range most of the year. These aggregates have not been strong counterpoints to the fast growing M1. Moreover, Fed officials have continued to refocus on M1 even after saying that it might be affected by some technical difficulties. With M1 way over the top of its target, M3's strong growth definitely has begun to close off some of the Fed's options. But what do we see for M3? Will it behave reasonably as the year unfolds?

No, I don't think that it will. Flow of funds data indicate that individuals have diverted massive amounts of funds from U.S. government Treasury and agency securities and open market paper. These funds, about $80 billion (SAAR) in the first quarter of 1983, have helped to balloon the deposits in bank MMDA accounts. Because MMDA accounts are included in M2 and M3, while the diverted funds are from sources outside M3, a continued rechanneling could result in continued excessive growth of M3 as the year progresses. Furthermore, because banks have replaced individuals (and then some) as purchasers of Treasury issues, the growth of M3 is reinforced. This is one aspect of reintermediation, the increased use of banks by the public. The funds in the banks are part of M3; conversely, when the public bought Treasury securities directly, these funds were not part of M3. Thus it appears that the change in bank regulations is leading banks to carry more assets than they otherwise might. M3 is bolstered as banks seek funding sources for these assets (or as assets are sought to cover funds the banks have acquired).

The bottom line for money is that M1 is a real problem, M2 is probably irrelevant, and M3 is a potential problem. On the other hand, the economy is looking sturdier by the day; housing starts, at an annual rate of 1.79 million units, are very strong. Although we have seen recent attempts by the markets to rally, it's unclear how rates can improve given the monetary problems and the state of the economy. In this regard, rumors of Mr. Volcker's imminent reappointment are interesting. Failure to reappoint Mr. Volcker will inject new uncertainties into the current situation. A Volcker reappointment, however, does not change the current economic picture. New Chairman or old Chairman, the outlook is for interest rates that are firm and firming.

Robert A. Brusca

Irving Trust

Market Yields

	6/17/83 (Noon)	Week Ago	Year Ago
Prime Lending Rate at Irving Trust Company	10.50%	10.50%	16.50%
Effective since	2/28/83		
Discount Rate at Federal Reserve Bank	8.50	8.50	12.00
Federal Funds	8.88	8.75	14.13
Repurchase Agreements	8.88	8.63	13.00
U.S. Treasury Issues			
Bills			
3 months	8.95	9.04	13.08
6 months	9.28	9.36	14.17
1 year	9.50	9.59	14.40
Coupons			
2 years	10.08	10.10	14.80
4 years	10.37	10.45	14.80
7 years	10.62	10.80	14.65
10 years	10.67	10.83	14.35
Long Bond	10.75	10.92	14.08
Negotiable Certificates of Deposit-Secondary Market			
1 month	9.00	9.00	14.60
3 months	9.10	9.25	15.00
6 months	9.45	9.50	15.25
1 year	9.75	9.95	15.25
Banker's Acceptances			
1 month	8.99	9.05	14.60
3 months	9.15	9.30	15.05
6 months	9.45	9.50	15.20
Eurodollar Deposits			
1 month	9.38	9.38	15.50
2 months	9.44	9.50	15.88
3 months	9.50	9.63	16.13
Commercial Paper - Prime Names			
Directly placed by:			
Finance Companies			
1 week	9.02	8.89	14.23
1 month	9.19	9.19	14.62
3 months	9.21	9.34	14.58
Bank Holding Companies			
1 month	8.68	9.07	14.36
Dealer Placed:			
3 months	9.24	9.39	14.71
New AA Corporate Utility Bond	11.80	11.80	16.80
Tax Exempt			
6 month Project Notes	4.90	4.95	8.00
1 year AAA Bond	5.50	5.55	8.00
5 year AAA Bond	6.75	7.00	9.75
20 year AAA Bond	8.70	9.50	11.90

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Financial Markets

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**Economic Research &
Planning Division**

Friday
(Noon)

June 24, 1983

The prices on government securities auctioned this week continued their decline, in part because the auctions were conducted in a very uncertain market environment. The sharp $5.6 billion surge in money supply last week caught most by surprise. It leaves M1 way over the top of its target--by about $20 billion. Those market participants who were (supposedly) "looking through" last week's M1 increase to declines this week are now looking at forecasts of much smaller declines than were expected before. This has further dampened market sentiment. Government securities dealers have been discouraged from taking positions by the prospect for continued uncertainty on the direction of Fed policy.

Some participants contend the Fed has tightened its policy. Others insist the Fed has done nothing. Clarification of this issue would help market performance greatly. However, because we have just passed a corporate tax payment date, and now mid-year is upon us, certain technical factors are in force that could--by themselves--keep the rate for Fed funds "excessively" high: The Fed typically does not accommodate extraordinary demands for funds at quarter-end or year-end. Thus, as the auctions occurred, securities dealers were undoubtedly aware that a seasonally strong funds rate was expected and would make it unlikely for a bond market rally to occur soon. The usual mid-year tightness will put off to the future any clarification of Fed policy (which now is taken to be the trading range for Fed funds).

My position in this debate on the Fed is that the Fed has already firmed its policy. The market now is suffering from an overdose of M1, and the Fed has decided to take a modest action. The Fed can no longer assert that the growth of M1 is merely technical. It is true that the fastest growing component of M1 is the other checkable deposits category that includes NOW and Super NOW accounts. This component has grown at a 38% rate over the past year; 60% over the last month. However, currency has also been growing rapidly, 9%-11% for most periods over the last year. More importantly, over the last month, demand deposits have increased their rate of growth from 4% to 18%. It's probably true that the fast growth of other checkables reflects a switch of funds from demand deposits to other checkables, possibly also some funds from other sources. However, the persistence of the growth of other checkables, coupled with the recent surge in demand deposits, makes it hard for the Fed to dismiss money growth for any reason.

The breadth of the M1 money growth problem is becoming apparent. At the same time, M3 hovers at the top of its target range. The economy is stronger, and if the second quarter strengthens beyond the "flash" estimate, the velocity of M1 might even rise. The Fed has missed (or seems to be missing) the last three M1 targets it has set. This has been justified by the continued abnormal behavior of M1's velocity. But should M1's velocity start to grow, particularly when M1 itself is growing so fast, the Fed would be hard pressed to ignore it. Right now, the odds must favor a further tightening by the Fed.

Robert A. Brusca

Irving Trust

Market Yields

	6/24/83 (Noon)	Week Ago	Year Ago
Prime Lending Rate at Irving Trust Company	10.50%	10.50%	16.50%
Effective since	2/28/83		
Discount Rate at Federal Reserve Bank	8.50	8.50	12.00
Federal Funds	9.00	8.88	14.88
Repurchase Agreements	8.88	8.88	13.13
U.S. Treasury Issues			
Bills			
3 months	9.32	8.95	13.57
6 months	9.61	9.28	14.40
1 year	9.86	9.50	14.59
Coupons			
2 years	10.41	10.08	14.93
4 years	10.73	10.37	14.91
7 years	10.96	10.62	14.88
10 years	10.96	10.67	14.71
Long Bond	11.01	10.75	14.22
Negotiable Certificates of Deposit-Secondary Market			
1 month	9.30	9.00	14.90
3 months	9.30	9.10	15.40
6 months	9.60	9.45	15.65
1 year	9.95	9.75	15.65
Banker's Acceptances			
1 month	9.24	8.99	14.80
3 months	9.42	9.15	15.40
6 months	9.64	9.45	15.70
Eurodollar Deposits			
1 month	9.63	9.38	15.75
2 months	9.75	9.44	16.13
3 months	9.75	9.50	16.50
Commercial Paper - Prime Names			
Directly placed by:			
Finance Companies			
1 week	8.63	9.02	14.62
1 month	9.33	9.19	14.88
3 months	9.34	9.21	15.25
Bank Holding Companies			
1 month	9.07	8.68	14.62
Dealer Placed:			
3 months	9.56	9.24	14.98
New AA Corporate Utility Bond	12.10	11.80	16.65
Tax Exempt			
6 month Project Notes	4.80	4.90	8.00
1 year AAA Bond	5.10	5.50	8.25
5 year AAA Bond	6.50	6.75	9.60
20 year AAA Bond	9.40	8.70	11.65

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Financial Markets

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**Economic Research &
Planning Division**

Friday
(Noon)

July 1, 1983

The debate continues: Did it or didn't it? Right now, only the FOMC knows for sure. The debate, of course, is over the question of whether the Fed has tightened its policy. Instead of speculating about likely prospects, let's see what kind of policy actions the Fed has been dealing out; let's peek into its hand.

When it comes to Fed action (rather than reaction, where money supply is the key), the market looks most closely at the rate for Fed funds and at the net (free or borrowed) reserve position of banks vis-a-vis the Fed. The average, or effective, Fed funds rate has risen week by week since May 11, the week of the infamous $7.2 billion M1 increase. The effective Fed funds rate rose from a low of 8.48% that week to 9.14% for the week ending June 22 (These are weeks in the sense of reserve maintenance periods: Thursday to Wednesday). Over that same period, the net reserve position of banks with the Fed swung back and forth: three weeks of net free reserves, four weeks of net borrowed--no clear pattern. Some analysts claim that this is evidence that the Fed is not behind the increase in the funds rate. They assert that the Fed is leaving free reserves in the system on occasion rather than restricting the supply of reserves to force borrowing from the Fed, an action that could pressure interest rates. This is the argument, but I think it is wrong. It peeks at only a few of the cards in the Fed's hand.

Remember that the Fed deals out reserves all week long, and so the funds rate is the result of the actual (and expected) supply of reserves in the market throughout the week, not just at the week's end. Realizing this, we can reveal the Fed's hand. In the six weeks following the $7.2 billion surprise, five saw net free reserve positions on Wednesday--the last day of the statement week. Each of the previous six weeks had shown net borrowed reserves on Wednesday, a sharp change in practice. This change implies a marked impact on the rest of the week's reserve pattern: Thursday to Tuesday. It means that after May 11, the Fed switched from its past policy of holding free reserves in the market all week and tightening on Wednesday, to the opposite policy of keeping reserves tight all week long, then injecting more on Wednesday. For example, during the first six days of each of the six weeks after May 11, five were periods of net borrowed reserves. The previous five weeks had shown just the opposite behavior for comparable six-day periods. Interest rates have firmed since May 11 because Fed funds traders usually have found their market short of reserves (all days of the week, save one), and this has been Fed policy.

The Fed has used a period of market uncertainty amid concern over money supply growth to impart firmness to the Fed funds rate. It has done this in a way that is very subtle and has analysts arguing over Fed intentions even after the rate has risen 50 to 60 basis points! However, a closer peek over the Fed's shoulder and into its hand does reveal the Fed's strategy. This clearly has been to raise rates without creating too much commotion in a period of great uncertainty over the economy. We can expect the Fed to continue to play these obscure hands.

Robert A. Brusca

Irving Trust

Market Yields

	7/1/83 (Noon)	Week Ago	Year Ago
Prime Lending Rate at Irving Trust Company	10.50%	10.50%	16.50%
Effective since	2/28/83		
Discount Rate at Federal Reserve Bank	8.50	8.50	12.00
Federal Funds	9.38	9.00	14.88
Repurchase Agreements	9.38	8.88	12.00
U.S. Treasury Issues			
Bills			
3 months	9.07	9.32	13.10
6 months	9.43	9.61	14.00
1 year	9.63	9.86	14.28
Coupons			
2 years	10.23	10.41	14.62
4 years	10.63	10.73	14.74
7 years	10.92	10.96	14.67
10 years	10.94	10.96	14.43
Long Bond	11.00	11.01	13.91
Negotiable Certificates of Deposit-Secondary Market			
1 month	9.10	9.30	14.85
3 months	9.20	9.30	15.15
6 months	9.45	9.60	15.35
1 year	9.85	9.95	15.35
Banker's Acceptances			
1 month	9.05	9.24	14.85
3 months	9.15	9.42	15.15
6 months	9.45	9.64	15.30
Eurodollar Deposits			
1 month	9.50	9.63	15.50
2 months	9.63	9.75	15.75
3 months	9.63	9.75	15.88
Commercial Paper - Prime Names			
Directly placed by:			
Finance Companies			
1 week	9.02	8.63	14.74
1 month	9.19	9.33	15.02
3 months	9.34	9.34	15.25
Bank Holding Companies			
1 month	9.07	9.07	14.88
Dealer Placed:			
3 months	9.43	9.56	15.25
New AA Corporate Utility Bond	12.15	12.10	16.50
Tax Exempt			
6 month Project Notes	4.75	4.80	7.95
1 year AAA Bond	5.50	5.10	8.25
5 year AAA Bond	7.00	6.50	9.60
20 year AAA Bond	9.40	9.40	11.75

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Economic Research &
Planning Division

Friday
(Noon)

July 8, 1983

Over the past several weeks, the bond market has undergone a severe backup in prices. The yield on the bellwether long government bond has risen from it's recent cyclical low of 10.27% to as high as 11.35%. This backup has undoubtedly disturbed the Fed. The Fed has tried to firm up short-term rates to help stem the rise in M1, but had hoped the subtle move would not impair the bond market's performance. Indeed, the realization that the Fed was fighting inflation could have helped to hold bond prices steady. That it did not tells us something about market psychology and spells trouble for the Fed.

In testimony before the Senate and House banking committees, Mr. Volcker has admitted that he has no magic buttons to press to control interest rates. The Fed *can* control the Fed funds rate and, to a lesser extent, can influence CD rates and, to a still lesser extent, bond rates. The Fed has been caught in this dilemma for most of this year. It has been torn between the possible need to raise short rates to stem the fast growth of M1 and the perceived need to keep bond rates and consumer loan rates down to fuel economic recovery. The recovery has occurred so far because several interest-sensitive sectors of the economy have performed well: autos and housing. Auto sales depend on short-term consumer financing rates. Mortgage rates are long-term rates that tend to track with bond rates. Thus an upward shift in the yield curve (increases in rates of all maturities) threatens several key economic sectors.

In terms of rates for the longer maturities, the Fed may be hurt by its own credibility. The bond market has seen the Fed's strong reaction in the past; thus it may fear that a near-term sharp rise in rates could occur again. Bond traders certainly are wary of this possibility, even as they are also aware that there are good reasons why rates "can't" rise too sharply this year. There is considerable debate over how the long end of the market "should" react. It certainly can't wait 30 years to see what real after-tax yields will be. However, it probably wants more proof of Fed intentions. Furthermore, large budget deficits are widely forecasted, and repercussions are feared. The market is more likely to look to the future after it is assured that these deficits won't drive rates out of sight. It would need to see economic growth sustained without driving rates up to gain some measure of reassurance. Thus an edgy, overreactive bond market will be a problem for the Fed over the foreseeable future.

To the extent that the Fed may wish to twist the yield curve (raise short rates and hold long rates), its credibility is essential. Therefore, the Fed's monetary targets are essential too. Credibility is an ongoing characteristic that must be nurtured. Even with what the Fed has done in the past to reduce inflation, it's hard to get people to hold the long bonds as short rates rise. The Fed did try to sneak up short rates without a bond market reaction, but this strategy has proved unsuccessful. The Fed now confronts a strong economy, fast growing money, and prospects that further interest rate rises will spread across the yield curve. At this time, the policy trade-offs are bleak. Fear of budget deficits is so widespread that twisting the yield curve seems to be out of the question. When short rates rise, the long rates will go with them--at least for awhile.

Robert A. Brusca

Irving Trust

Market Yields

	7/8/83 (Noon)	Week Ago	Year Ago
Prime Lending Rate at Irving Trust Company	10.50%	10.50%	16.50%
Effective since	2/28/83		
Discount Rate at Federal Reserve Bank	8.50	8.50	12.00
Federal Funds	9.00	9.38	13.88
Repurchase Agreements	8.88	9.38	12.50
U.S. Treasury Issues			
Bills			
3 months	9.39	9.07	12.13
6 months	9.84	9.43	13.04
1 year	10.19	9.63	13.47
Coupons			
2 years	10.61	10.23	13.98
4 years	10.97	10.63	14.22
7 years	11.25	10.92	14.16
10 years	11.24	10.94	14.00
Long Bond	11.29	11.00	13.58
Negotiable Certificates of Deposit-Secondary Market			
1 month	9.30	9.10	13.65
3 months	9.50	9.20	14.15
6 months	9.90	9.45	14.10
1 year	10.20	9.85	14.20
Banker's Acceptances			
1 month	9.30	9.05	13.75
3 months	9.55	9.15	14.00
6 months	9.85	9.45	14.05
Eurodollar Deposits			
1 month	9.75	9.50	14.63
2 months	9.88	9.63	14.88
3 months	10.00	9.63	15.13
Commercial Paper - Prime Names			
Directly placed by:			
Finance Companies			
1 week	9.27	9.02	13.21
1 month	9.33	9.19	13.84
3 months	9.47	9.34	14.17
Bank Holding Companies			
1 month	9.07	9.07	13.84
Dealer Placed:			
3 months	9.57	9.43	14.17
New AA Corporate Utility Bond	12.30	12.15	16.20
Tax Exempt			
6 month Project Notes	4.60	4.75	7.45
1 year AAA Bond	5.50	5.50	8.00
5 year AAA Bond	6.45	7.00	9.60
20 year AAA Bond	9.30	9.40	11.70

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7/20/83

Financial Markets

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Irving Trust

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**Economic Research &
Planning Division**

Friday
(Noon)

July 15, 1983

The FOMC has met to discuss and review the monetary targets for 1983; soon Mr. Volcker will share the results of those deliberations with the Senate and House banking committees in his mid-year testimony. Yesterday in his confirmation hearing before the Senate Banking Committee, he did say, "I don't think you'll find those decisions terribly dramatic." The Fed has had several options open. For instance, it could change the targets, or emphasize one aggregate more than the others. However, I think it most likely that the Fed has made no such change. Monetary policy will continue to be subject to a greater degree of discretion than has been the case since October of 1979. There are many needs that the Fed must weigh.

Mr. Volcker, in his testimony before the banking committees, will undoubtedly stress the need for economic recovery, explaining it in terms of domestic and international interests. And, although the economy is stronger-looking each day, he can be expected to point to the fragility that characterizes a recovery in its early phases. In the forefront of Mr. Volcker's mind will be two contrary elements: memory of the aborted recovery of 1980, after the Fed let interest rates soar again; and the current reality of continued excessive M1 growth this year, which seems to call for an increase in interest rates.

Some have suggested that the Fed might agree to change the monetary targets at this mid-year meeting. This, it is alleged, would give the Fed more scope to maneuver. (M1 currently is well above the top of its target, arguably making it difficult for the Fed to allow interest rates to go lower and possibly creating an impression that rates should rise sharply.) On the face of it, this argument has merit, but on second thought such a move does not seem worth the risk.

The risk is that the Fed might reset its targets and still miss them at year-end, thus impairing further the Fed's credibility. The Fed has not had a good record in targeting money growth recently: It missed its 1982 M1 target; it is missing its 1983 target; and it missed its interim 1983 target. Because of this record, the Fed could not afford to set a new target, then miss it. Thus in some ways the Fed is left with more flexibility by keeping its targets unchanged and by appealing to use of judgment in policymaking.

Moreover, a change in the targets is not necessary. M2 is well within its target, and M3 hovers near the top of its growth range. M1 is the clear and present problem. So far the Fed has downplayed M1 because of its continued erratic relationship with GNP. This relationship, M1's velocity, is, however, beginning to look less unusual than it has. In fact, M1's velocity might even increase in the second quarter. If this happens, the Fed is more likely to be concerned with M1's growth. On balance, the Fed's policy aims are likely best served by a continuation of the Fed's current moderately restrictive policies, with a large measure of judgment and the same M1 target.

Robert A. Brusca

Irving Trust

Market Yields

	7/15/83 (Noon)	Week Ago	Year Ago
Prime Lending Rate at Irving Trust Company	10.50%	10.50%	16.50%
Effective since	2/28/83		
Discount Rate at Federal Reserve Bank	8.50	8.50	12.00
Federal Funds	9.38	9.00	12.75
Repurchase Agreements	9.25	8.88	12.13
U.S. Treasury Issues			
Bills			
3 months	9.42	9.39	11.77
6 months	9.92	9.84	12.70
1 year	10.27	10.19	13.16
Coupons			
2 years	10.76	10.61	13.84
4 years	11.19	10.97	13.97
7 years	11.39	11.25	13.95
10 years	11.42	11.24	13.82
Long Bond	11.43	11.29	13.50
Negotiable Certificates of Deposit-Secondary Market			
1 month	9.30	9.30	13.50
3 months	9.55	9.50	13.95
6 months	10.05	9.90	13.95
1 year	10.40	10.20	14.00
Banker's Acceptances			
1 month	9.32	9.30	13.40
3 months	9.70	9.55	13.90
6 months	10.05	9.85	13.90
Eurodollar Deposits			
1 month	9.82	9.75	14.00
2 months	10.00	9.88	14.50
3 months	10.25	10.00	14.63
Commercial Paper - Prime Names			
Directly placed by:			
Finance Companies			
1 week	9.27	9.27	12.84
1 month	9.45	9.33	13.46
3 months	9.74	9.47	13.76
Bank Holding Companies			
1 month	9.07	9.07	13.32
Dealer Placed:			
3 months	9.62	9.57	13.62
New AA Corporate Utility Bond	12.60	12.30	16.25
Tax Exempt			
6 month Project Notes	4.90	4.60	7.80
1 year AAA Bond	5.50	5.50	8.25
5 year AAA Bond	6.75	6.45	9.50
20 year AAA Bond	8.75	9.30	11.70

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Financial Markets

Irving Trust

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Economic Research &
Planning Division

Friday
(Noon)

July 29, 1983

One small slice of humble pie, please. Yes, I am fully aware that in my last letter (July 15) I stated that the Fed would not change its M1 target at its mid-year target review. However, I argued (and still maintain) that changing that target was not worth the risk. It would not be advisable now for the Fed to hit the new M1 target "no matter what." Still, it will impair the Fed's credibility to miss yet another M1 target. Indeed, the markets have lost a lot of ground since this change in the M1 target was announced. I think the market is not reassured by what the Fed did. Let's look at the new policy environment.

First, the Fed has downgraded M1 formally to an aggregate with a monitoring zone, not a target zone; M1 has the same status as the experimental credit aggregate--hard to believe. Also, the Fed admits to becoming slightly less accommodating in its policy; the first steps occurred in a split vote at the May 24 FOMC meeting shortly after M1 had risen $7.1 billion in one week (May 11). This policy move evidently was prompted by M1's rising against the background of a strong economy. Clearly M1 has been an important element in the Fed's policy response, and that remains true even with the formal downgrading of the aggregate's status. After all, if M1 were irrelevant would the Fed have bothered to set a new target range for it?

The Fed had laid the groundwork for missing its original M1 target this year by saying that M1's desired performance depended on the performance of M1's velocity. Instead, the Fed abolished that target, made a fairly explicit bet on velocity, and set a new target. If the economy expands at just a 10% nominal rate in the second half of 1983, a 1% velocity increase will be needed if the new M1 target of 9% maximum growth is to be reached; stronger GNP growth requires a larger increase in velocity. Velocity did increase in the second quarter, but only marginally. So why would the Fed take such a chance?

This is the hard question to answer. Setting another target for M1, and one that might not be reached, does not help the Fed's public image. The continuing shift of the aggregate's base (from which growth is calculated) and change in the growth rate make the Fed's activities look more and more like those undertaken by the Fed under the leadership of Arthur Burns, when inflation was a problem. While Volcker is not Burns, neither will Volcker be around as long as was Burns. Thus whatever personal reassurance Mr. Volcker brings, it does not necessarily carry fully into the long end of the market and transcend the Fed as an institution.

Even the setting of tighter M2 and M3 targets next year does not satisfy. Look at how shabbily the M1 target has been treated this year! Moreover, some feel that M1 is so close to the new range that the Fed will have to pay attention to it. Thus market attention has come to be more riveted on M1, not less. And fear of the large budget deficits continues. In this environment, the Fed now has a monumental task even in articulating its policy. Yet nothing has really changed that much. M1 is playing a more schizophrenic role; M1's velocity is a central issue; while discretion and judgment reign supreme. Through all this, it is not clear what a consistent Fed policy would look like. This is one reason why the markets are so unsettled, and why I have ordered humble pie but will not eat it.

Robert A. Brusca

Irving Trust

Market Yields

	7/29/83 (Noon)	Week Ago	Year Ago
Prime Lending Rate at Irving Trust Company	10.50%	10.50%	15.50%
Effective since	2/28/83		
Discount Rate at Federal Reserve Bank	8.50	8.50	11.50
Federal Funds	9.50	9.38	11.25
Repurchase Agreements	9.13	9.20	9.25
U.S. Treasury Issues			
Bills			
3 months	9.50	9.41	10.68
6 months	9.97	9.81	11.93
1 year	10.35	10.15	12.49
Coupons			
2 years	10.91	10.73	13.44
4 years	11.37	11.13	13.65
7 years	11.62	11.33	13.80
10 years	11.66	11.36	13.68
Long Bond	11.68	11.40	13.40
Negotiable Certificates of Deposit-Secondary Market			
1 month	9.45	9.30	11.35
3 months	9.60	9.45	12.00
6 months	10.15	9.95	12.75
1 year	10.55	10.35	13.25
Banker's Acceptances			
1 month	9.40	9.32	11.30
3 months	9.70	9.57	11.95
6 months	10.17	9.92	12.90
Eurodollar Deposits			
1 month	9.75	9.63	12.19
2 months	10.00	9.81	12.56
3 months	10.13	9.94	13.00
Commercial Paper - Prime Names			
Directly placed by:			
Finance Companies			
1 week	9.40	9.14	10.67
1 month	9.45	9.33	11.51
3 months	9.74	9.60	11.88
Bank Holding Companies			
1 month	9.19	9.07	11.39
Dealer Placed:			
3 months	9.63	9.58	11.74
New AA Corporate Utility Bond	13.00	12.60	15.85
Tax Exempt			
6 month Project Notes	4.95	4.95	7.25
1 year AAA Bond	5.50	5.10	7.75
5 year AAA Bond	7.00	7.00	9.20
20 year AAA Bond	9.30	9.00	11.10

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Financial Markets

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**Economic Research &
Planning Division**

Friday
(Noon)

August 5, 1983

At last, after substantial urging and cajoling by Chairman Volcker, the House of Representatives has passed legislation favoring the $8.4 billion increased contribution of the U.S. to the IMF. While the Senate and House have yet to iron out their differences on this bill, I believe that optimism is appropriate at this point. Congress is to be commended for passing essential legislation that probably doesn't earn many votes "back home." This is unfortunate. Indeed, it's true that the IMF bill has come to be seen as legislation that helps the banks; but the true constituency for this legislation is much broader.

Providing the IMF with greater financial resources benefits the world economy: importers, exporters, financiers, and others. IMF financial resources will not replace those of the commercial banks but, rather, will enhance them. The IMF is too small to ever replace the banks. Moreover, the IMF currently requires private banks to increase their contributions to needy borrowers before the IMF will agree to lend. Thus, the increased IMF contribution by the U.S., and that of other IMF member countries, helps developing countries to keep their debt payments current and their imports at somewhat higher levels than they otherwise could support. This helps to prop up global demand and to stave off possible political crises in the LDCs.

Nonetheless, some hold that further payment to the IMF is not appropriate. To some, funds paid to the IMF are merely another government expenditure further exacerbating the already excessive level of government spending. However, the U.S. earns interest on its IMF contributions approximately equal to the Treasury's borrowing costs. Thus, IMF contributions, unlike other government spending, do not represent a net financial drain. Furthermore, Chairman Volcker has pointed to increased IMF contributions as a way to help diminish the systemic risk of international lending.

The current synchronized global recession has intensified the risks of lending internationally: It has made some risks nondiversifiable. To the extent that these risks are due to tight global financial conditions, the commercial banks should not be held responsible. The widespread debt problems are the result of a global anti-inflation effort. Support of the banking system must be part of this program. Yet some country-specific risk must remain because this is the essence of competitive international financial markets. A modest IMF resource injection is widely thought to be the best means to achieve these ends.

Still, the debt problem is a hard one to solve. Its solution is not made easier by current rising U.S. interest rates. However, the Federal Reserve remains alert to the international implications of its policies. At the same time, the Fed stands guard against inflation: thus rising rates. The Fed clearly believes that sustained economic recovery in the U.S. is a critical ingredient to the long-term solution of the debt problem. Modestly rising interest rates are a short-term cost of this long-term goal.

Robert A. Brusca

Irving Trust

Market Yields

	8/5/83 (Noon)	Week Ago	Year Ago
Prime Lending Rate at Irving Trust Company	10.50%	10.50%	15.00%
Effective since	2/28/83		
Discount Rate at Federal Reserve Bank	8.50	8.50	11.00
Federal Funds	9.63	9.50	10.75
Repurchase Agreements	9.50	9.13	10.75
U.S. Treasury Issues			
Bills			
3 months	9.77	9.50	10.44
6 months	10.23	9.97	11.68
1 year	10.62	10.35	12.44
Coupons			
2 years	11.25	10.91	13.14
4 years	11.69	11.37	13.73
7 years	11.99	11.62	13.83
10 years	12.10	11.66	13.72
Long Bond	12.11	11.68	13.73
Negotiable Certificates of Deposit-Secondary Market			
1 month	9.65	9.45	11.15
3 months	9.90	9.60	11.55
6 months	10.30	10.15	12.35
1 year	10.90	10.55	13.00
Banker's Acceptances			
1 month	9.55	9.40	10.95
3 months	9.98	9.70	11.20
6 months	10.50	10.17	11.30
Eurodollar Deposits			
1 month	10.00	9.75	11.75
2 months	10.25	10.00	12.25
3 months	10.50	10.13	12.69
Commercial Paper - Prime Names			
Directly placed by:			
Finance Companies			
1 week	9.40	9.40	10.92
1 month	9.71	9.45	11.00
3 months	10.00	9.74	11.20
Bank Holding Companies			
1 month	9.33	9.19	10.74
Dealer Placed:			
3 months	9.94	9.63	11.20
New AA Corporate Utility Bond	13.45	13.00	15.65
Tax Exempt			
6 month Project Notes	5.25	4.95	6.75
1 year AAA Bond	5.50	5.50	7.75
5 year AAA Bond	7.10	7.00	8.75
20 year AAA Bond	9.30	9.30	11.25

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Financial Markets

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Economic Research &
Planning Division

Friday (Noon) Aug. 12, 1983

With the Treasury auctions out of the way, the financial markets can now turn to factors that are less tactical and more fundamental. Auction time is always an opportunity for positioning. It fosters a really grand ballet in which government securities dealers try to outwit potential customers. All the financial-markets players are participants in this dance. Now that the tactical opportunity has passed, the market can get down to business.

The government always auctions all its debt. The question is, at what price? Dealers become understandably reticent to "buy the auction" if the market's mood is down. Dealers may prefer to sell off some inventory, take a loss on the market's decline, and try to make it up by bidding at the auction and reselling later at better prices. They might try to set "short" positions before the auction and hope for an improved price performance at auction. Many different strategies are possible. However, all have the common element of realizing that the auctions will be done at some price, and that if sufficient customer demand doesn't develop, the dealers themselves will own the government paper.

The dealers are kept "honest" in this game by the existence of other dealers and by sophisticated final purchasers. However, the laws of economics do not provide a consistent, reliable valuation of bond prices, so that short-term price swings can be volatile and disconcerting. In the recent auction, the new long bond carried a yield of over 12%, a sizable change from the 11.68% yield on July 29, just four business days before the auction.

So far this week (up to Friday), the long-term markets have done better. Yet short-term rates remain firm and will probably continue to rise. But since no new government supply is coming on stream for a while, the market has a chance to consider current yield levels in isolation from the previous tactical environment. When one looks at the fundamentals, bonds look more attractive--and while still prone to risk--perhaps worth it.

July retail sales softened, refocusing attention on the interest sensitivity of the economy. Mortgage rates are already so high they clearly are slowing the housing market. Even if short-term rates firm to try and rein in money growth, can the long-term market back up much more? Will the Fed pursue its new M1 "target"--excuse me, "monitoring zone"--without regard to other consequences? How much more of an interest rate backup can auto sales withstand? The answers to these types of questions have reassured potential bond buyers. It seems unlikely that long rates will push to much higher levels, even if the Fed continues to let the funds rate rise a modest 10 basis points per week. How much longer? September? October? The market is also reassured by better looking M2 and M3 aggregates for July. It looks like M1 will stand alone as a problem. With these circumstances, it is possible that the bond market could cease to back up and to consider a modest rally, even given prospects that short-term rates might move up slowly for a while longer. The Fed will have ample excuse to lower interest rates when economic growth slows, whether or not M1 remains over target. For now, this news seems to reassure the bond market.

Robert A. Brusca

Irving Trust

Market Yields

	8/12/83 (Noon)	Week Ago	Year Ago
Prime Lending Rate at Irving Trust Company	11.00%	10.50%	15.00%
Effective since	8/8/83		
Discount Rate at Federal Reserve Bank	8.50	8.50	11.00
Federal Funds	9.63	9.63	10.38
Repurchase Agreements	9.50	9.50	9.63
U.S. Treasury Issues			
Bills			
3 months	9.85	9.77	9.58
6 months	10.27	10.23	11.05
1 year	10.68	10.62	11.90
Coupons			
2 years	11.24	11.25	12.80
4 years	11.69	11.69	13.39
7 years	11.91	11.99	13.47
10 years	12.01	12.10	13.40
Long Bond	11.97	12.11	13.04
Negotiable Certificates of Deposit-Secondary Market			
1 month	9.70	9.65	10.05
3 months	10.00	9.90	11.20
6 months	10.40	10.30	11.85
1 year	11.00	10.90	12.25
Banker's Acceptances			
1 month	9.68	9.55	10.60
3 months	10.05	9.98	11.15
6 months	10.51	10.50	11.80
Eurodollar Deposits			
1 month	9.88	10.00	11.38
2 months	10.25	10.25	12.00
3 months	10.44	10.50	12.25
Commercial Paper - Prime Names			
Directly placed by:			
Finance Companies			
1 week	9.53	9.40	9.14
1 month	9.84	9.71	10.36
3 months	10.13	10.00	10.67
Bank Holding Companies			
1 month	9.45	9.33	10.22
Dealer Placed:			
3 months	10.15	9.94	10.67
New AA Corporate Utility Bond	13.30	13.45	15.60
Tax Exempt			
6 month Project Notes	5.65	5.25	6.45
1 year AAA Bond	5.70	5.50	8.00
5 year AAA Bond	7.10	7.10	8.75
20 year AAA Bond	9.50	9.30	11.10

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Economic Research &
Planning Division

Friday
(Noon)

Aug. 19, 1983

The bond market has continued its good performance since the Treasury's auctions. Indeed, market sentiment has shifted abruptly to greater optimism--perhaps toward too much optimism. While it's hard to fault the bond market's recovery, the recent lowering of short-term rates seems much less durable. Money market certificates such as CDs have reduced their yield by about 25 basis points to 9 3/4%; Eurodollars have done even better. Attention has focused on a few days of the Fed funds rate falling below the lower limit of its recent trading range. Talk has begun to shift to the notion that the peak in rates is behind us, but is it?

I don't think so, at least not for money market rates. As for long rates, they will probably back up again, well before year-end, but bonds may not pierce the low price levels reached at the last auction. These determinations are based on a view of the Fed's likely reaction to recent events and my perception that the short end of the market has falsely followed the improvement in long rates. So what is the Fed's next move?

Almost certainly the next move will be to firmer rates. The market's recent infatuation with slow money supply growth misses the most crucial point: the economy. Having money supply (M1) within "target" is neither a necessary nor a sufficient condition for lower interest rates. Conversely, a weakening economy is both necessary and sufficient to prompt the Fed to lower rates. The latter point is quite clear; the point about money supply may not be. To understand it, realize that the Fed would be very worried about further excessive money growth because of the high level of the current M1 monitoring zone. Also realize that lower growth, within the new monitoring zone, would be well above the upper limit that the Fed previously had intended for M1 by this time in the year. The Fed had said that the performance of M1's *velocity* would determine where the Fed would like M1 to be within the (original, broad) 4%-8% target range it had set. Thus the role played by the economy should be easier to see: *If* the economy remains strong and *if* money supply growth slows, that means *velocity* will be rising. An indication of rising velocity would surely put the Fed on the defensive, *even if* M1 is within its new monitoring zone.

All this analysis is very pessimistic stuff for a market as bullish as the one we have been in. But the market is behaving as markets do: wary of the longer-term factors and trading the short-term trends. For now, M1 has given the market heart: a better-than-expected number last Friday (Aug. 12), prospects of small declines this week and next week--but for the last two weeks in August a cumulative increase of $6 billion. These increases are too distant in time to trade on now. Near term, the market seems insulated from a dramatic money supply shock. As a result, we may have as much as a week or two of good performance in the bond market, perhaps less in the money market, before reality sets in.

Robert A. Brusca

Irving Trust

Market Yields

	8/19/83 (Noon)	Week Ago	Year Ago
Prime Lending Rate at Irving Trust Company	11.00%	11.00%	14.00%
Effective since	8/8/83		
Discount Rate at Federal Reserve Bank	8.50	8.50	10.50
Federal Funds	9.50	9.63	8.63
Repurchase Agreements	9.25	9.50	7.25
U.S. Treasury Issues			
Bills			
3 months	9.65	9.85	6.87
6 months	10.02	10.27	8.74
1 year	10.33	10.68	9.84
Coupons			
2 years	10.84	11.24	11.08
4 years	11.30	11.69	12.05
7 years	11.58	11.91	12.30
10 years	11.69	12.01	12.26
Long Bond	11.69	11.97	12.16
Negotiable Certificates of Deposit-Secondary Market			
1 month	9.55	9.70	9.20
3 months	9.70	10.00	9.55
6 months	10.00	10.40	10.50
1 year	10.55	11.00	11.00
Banker's Acceptances			
1 month	9.60	9.68	9.00
3 months	9.77	10.05	9.50
6 months	10.10	10.51	10.40
Eurodollar Deposits			
1 month	9.88	9.88	9.88
2 months	10.00	10.25	10.00
3 months	10.19	10.44	10.25
Commercial Paper - Prime Names			
Directly placed by:			
Finance Companies			
1 week	9.27	9.53	6.09
1 month	9.59	9.84	8.17
3 months	9.87	10.13	8.81
Bank Holding Companies			
1 month	9.33	9.45	7.91
Dealer Placed:			
3 months	9.84	10.15	8.81
New AA Corporate Utility Bond	12.88	13.30	14.13
Tax Exempt			
6 month Project Notes	5.65	5.65	5.00
1 year AAA Bond	5.50	5.70	6.75
5 year AAA Bond	7.20	7.10	8.50
20 year AAA Bond	9.30	9.50	10.00

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9/6/83 B4750-1

Financial Markets

Irving Trust

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**Economic Research &
Planning Division**

Friday
(Noon)

Aug. 26, 1983

The past two weeks have provided one of the most perplexing periods for the Fed funds rate so far this year. This episode has left Fed watchers confused and, in general, less certain of the direction of Fed policy. Two technical factors--one fairly obvious, the other less so--have distorted the Fed funds rate at a time when that rate has consistently traded well below its recent lower support levels. The question most asked is: Has Fed policy changed or is this technical? I think it's almost totally technical; here's why.

To understand the behavior of the Fed funds rate, realize that it is the result of the supply of bank reserves relative to needs and of market perceptions of what policy is. That psychology had been sour in early August when the funds rate traded for several days at levels as high as 9 7/8%. More recently, over the past several weeks, the funds rate has traded down as low as 9 1/8%. Now, because the bond market has improved and because money growth seems slower, some feel the Fed has eased. However, the recent weakening in the funds rate is the result of both psychological and technical elements, but represents little if any policy change.

The first and most subtle of the technical factors that lowered the funds rate recently was the Fed's agreement to purchase Treasury securities from foreign customers. That transaction injected $1 billion of reserves into the banking system on the week ended Aug. 17. Foreign central banks probably sold U.S. Treasuries to the Fed to cover dollar sales made in mid-August against their own weakening currencies. Because of the Fed's own need to inject reserves that week, the Fed took the foreigners' securities into its own portfolio, adding reserves. But the timing of this purchase was probably not totally to the Fed's liking. It resulted in an earlier reserve injection than the Fed has typically been making in a statement week. Thus the Fed funds market was somewhat more liquid, and funds therefore traded lower earlier in the week. Indeed, on Wednesday, the Fed was apparently still trying to drain some of this liquidity out to hit its net borrowed reserve target. The Fed has typically been supplying liquidity on Wednesday, after being stingy earlier in the week. This reversal of the typical pattern made the market feel more liquid than it really was.

As for the obvious technical factor, it's the hurricane, Alicia. It probably began disrupting payments patterns in Texas as early as Aug. 16. Such disruption increases the settlement lags in check processing between banks and gives rise to increased Federal Reserve float. This float increases the quantity of reserves available to banks and therefore helps push the Fed funds rate down. The Fed knew about this problem but did not move to counteract it. Some argue that this is evidence that the Fed has eased. However, the Fed may not have had enough information on float and may have decided to wait and basically write off last week as a miss. Certainly the matched-sales done on Thursday, Aug. 25, help to reinforce this view. The Fed is taking no chances with excess liquidity early in this statement week. It has thus operated both on market psychology and on reserve availability. It does not appear to have loosened its policy yet.

Robert A. Brusca

Irving Trust

Market Yields

	8/26/83(Noon)	Week Ago	Year Ago
Prime Lending Rate at Irving Trust Company	11.00%	11.00%	13.50
Effective since	8/8/83		
Discount Rate at Federal Reserve Bank	8.50	8.50	10.00
Federal Funds	9.38	9.50	9.88
Repurchase Agreements	9.25	9.25	8.50
U.S. Treasury Issues			
Bills			
3 months	9.45	9.65	7.80
6 months	9.90	10.02	9.78
1 year	10.35	10.33	10.76
Coupons			
2 years	10.93	10.84	11.76
4 years	11.34	11.30	12.59
7 years	11.58	11.58	12.70
10 years	11.70	11.69	12.61
Long Bond	11.66	11.69	12.37
Negotiable Certificates of Deposit-Secondary Market			
1 month	9.25	9.55	9.40
3 months	9.55	9.70	10.10
6 months	9.90	10.00	11.45
1 year	10.30	10.55	11.75
Banker's Acceptances			
1 month	9.35	9.60	9.40
3 months	9.67	9.77	10.05
6 months	10.00	10.10	11.45
Eurodollar Deposits			
1 month	9.75	9.88	10.25
2 months	10.00	10.00	10.75
3 months	10.25	10.19	11.25
Commercial Paper - Prime Names			
Directly placed by:			
Finance Companies			
1 week	9.27	9.27	8.12
1 month	9.45	9.59	8.68
3 months	9.74	9.87	9.34
Bank Holding Companies			
1 month	9.19	9.33	8.30
Dealer Placed:			
3 months	9.55	9.84	10.00
New AA Corporate Utility Bond	12.95	12.88	14.40
Tax Exempt			
6 month Project Notes	5.35	5.65	5.15
1 year AAA Bond	5.75	5.50	6.75
5 year AAA Bond	7.00	7.20	7.75
20 year AAA Bond	9.10	9.30	9.90

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9/8/83

Financial Markets

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Irving Trust

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Economic Research &
Planning Division

Friday
(Noon)

Sept. 2, 1983

Hindsight is always much clearer than foresight. And so the statistics reported by the Fed for last week, and the overview from the July 12-13 FOMC meeting, put recent money market events in a clearer light. The Fed has not loosened its policy; in fact, at the July meeting the FOMC voted to tighten somewhat. Still, the Fed operations of the last statement week have been perplexing to some. What is the Fed up to?

Clearly, the Fed is not up to easing its policy. The recent softness in rates reflected a problem with the timing of reserve injections rather than with anything fundamental (this was described in the last "Financial Markets" letter). However, Fed policy has changed. Earlier this year, Fed policy was expressed best by the Fed funds rate. Recently, Fed policy has come to be expressed best by the net borrowed reserve position of banks.

This means that the Fed is somewhat less concerned with strictly controlling the funds rate. Instead, it leaves the market some room to push that rate up or down; the Fed sends its signal through the level of net borrowings. As a result, the Fed funds rate is now more variable than it has been so far this year. Yet the Fed still pays attention to the Fed funds rate, and this explains the somewhat unsettling money market operations by the Fed during the last statement week.

After two weeks of a soft funds rate, the Fed decided a third such week would be a problem. As a result, it drained reserves on Thursday of last week via a matched sale transaction. This operation, while probably not large, left the market with less liquidity and helped to impart some firmness to the funds rate. But late in the week the Fed found the market was insufficiently liquid. It therefore went in on Wednesday and added reserves via a System RP--again probably a small transaction. While the Fed usually loathes draining, then resupplying, reserves in the same week, last week was probably an exception. The Thursday transaction (drain) was a calculated risk: Draining had to be done early or market psychology, tilted toward lower rates, might have gotten out of hand. There was no pressing need to drain reserves overall during the week, but having less liquidity early on was imperative. Then, as the week progressed, no other factors put reserves back in, so the Fed itself had to go back in and undo the effects of its earlier operation. These open market operations do not reflect poor performance by the Fed; rather, they reflect an attempt to regain some control of the funds rate.

The bottom line remains that the Fed prefers a firm funds rate at this time. Still, the July meeting provides some comfort. With Fed funds trading around 9.4% at the time of the meeting, the Fed agreed to exert more pressure on reserve positions but did not change the upper limit of the Fed funds trading range from 10%. While such a change remains as an option, it does not appear that the Fed intends to tighten up much more; but a firmness in rates can be expected to endure for a while longer.

Robert A. Brusca

Irving Trust

Market Yields

	9/2/83 (Noon)	Week Ago	Year Ago
Prime Lending Rate at Irving Trust Company	11.00%	11.00%	13.50%
Effective since	8/8/83		
Discount Rate at Federal Reserve Bank	8.50	8.50	10.00
Federal Funds	9.63	9.38	10.38
Repurchase Agreements	9.45	9.25	10.13
U.S. Treasury Issues			
Bills			
3 months	9.60	9.45	8.15
6 months	10.13	9.90	9.47
1 year	10.59	10.35	10.02
Coupons			
2 years	11.18	10.93	11.63
4 years	11.66	11.34	14.88
7 years	11.97	11.58	14.50
10 years	12.01	11.70	13.75
Long Bond	11.98	11.66	14.00
Negotiable Certificates of Deposit-Secondary Market			
1 month	9.50	9.25	10.40
3 months	9.70	9.55	10.75
6 months	10.15	9.90	11.75
1 year	10.45	10.30	12.30
Banker's Acceptances			
1 month	9.50	9.35	10.19
3 months	9.85	9.67	11.70
6 months	10.15	10.00	11.70
Eurodollar Deposits			
1 month	10.00	9.75	11.19
2 months	10.18	10.00	11.38
3 months	10.38	10.25	11.63
Commercial Paper - Prime Names			
Directly placed by:			
Finance Companies			
1 week	9.53	9.27	10.55
1 month	9.59	9.45	10.36
3 months	9.87	9.74	10.40
Bank Holding Companies			
1 month	9.19	9.19	9.19
Dealer Placed:			
3 months	9.71	9.55	10.27
New AA Corporate Utility Bond	13.00	12.95	14.60
Tax Exempt			
6 month Project Notes	5.65	5.35	5.25
1 year AAA Bond	5.70	5.75	7.00
5 year AAA Bond	7.00	7.00	7.75
20 year AAA Bond	9.30	9.10	10.00

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Financial Markets

Irving Trust

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Economic Research &
Planning Division

Friday
(Noon)

Sept. 9, 1983

The Fed continues to pursue its policy of being relatively restrictive with reserves. It has gotten control of the aberrant technical factors of recent weeks. Now it is overshooting its borrowing targets early in the week and injecting excess reserves on Wednesday, the last day of the Fed's statement week. This approach is underscored by the Fed's doing reserve-adding System RPs on Wednesday of each of the last two statement weeks. From these late-in-the-week operations, we must conclude that the Fed has come as close as is possible to its true net borrowed target: approximately $450 million, based on last week's results. The Fed has kept control of its net borrowed target even though this has meant some increased variability in the Fed funds rate. One result of this is to make small movements in the Fed funds rate less meaningful to the market. Thus attention has come to be focused more on M1's behavior and the Fed's next move.

This re-emphasis on M1 is important because M1 is no longer billions of dollars over the top of its growth range. With M1 now about $2.3 billion below the top of the new range, the market has become very dependent on the weekly outlook for money growth--more so than earlier this year. The new, mid-year, M1 growth bands of 5% to 9% represent a very narrow target: In mid-August, it's $5 billion wide; at end-December, it's $12.5 billion wide. Therefore even weekly developments in money growth can dramatically alter the position of M1 relative to its boundaries--and money growth is unpredictable. So far this year, 34% of the weekly changes in M1 have been greater than $3.0 billion; last year, 21% were greater than $3.0 billion. So M1 has become even more volatile this year than last. Thus, chances are pretty good that the money supply will bounce around erratically within--and possibly above--the target from now until the end of 1983. Much of this action will be unanticipated: The consensus forecast of money market economists this year has been a very poor guide to actual changes in M1.

The market is now focused on M1. The Fed, taken at its word, is more concerned with M1's velocity. Thus the Fed will gear its net borrowed target to account for velocity's performance. Even if M1's growth slows, the Fed will not necessarily let rates fall because velocity might be on the rise. A strong economy is likely to keep the Fed somewhat restrictive because fast GNP growth would likely be associated with an increase in velocity. Moreover, the Fed is likely to be most restrictive if M1 is over its target because money growth is not irrelevant. Yet, the M1 target is so narrow it will be hard to be sure how fundamentally strong or weak M1 really is, unless we get a dramatic change in M1's behavior. Because the market will anticipate the Fed's reaction, we may be in store for increased year-end interest rate volatility, driven by the market's inability to predict M1. The Fed will remain restrictive until the economy shows some signs of real weakness. Depending on where money is relative to its growth range, "restrictive" will mean different things.

Robert A. Brusca

Irving Trust

Market Yields

	9/9/83 (Noon)	Week Ago	Year Ago
Prime Lending Rate at Irving Trust Company	11.00%	11.00%	13.50%
Effective since	8/8/83		
Discount Rate at Federal Reserve Bank	8.50	8.50	10.00
Federal Funds	9.63	9.63	10.00
Repurchase Agreements	9.50	9.45	9.75
U.S. Treasury Issues			
Bills			
3 months	9.42	9.60	8.69
6 months	9.91	10.13	10.36
1 year	10.31	10.59	11.25
Coupons			
2 years	10.87	11.18	12.02
4 years	11.39	11.66	12.68
7 years	11.68	11.97	12.78
10 years	11.71	12.01	12.64
Long Bond	11.71	11.98	12.34
Negotiable Certificates of Deposit-Secondary Market			
1 month	9.40	9.50	10.50
3 months	9.50	9.70	10.80
6 months	9.80	10.15	11.70
1 year	10.25	10.45	12.25
Banker's Acceptances			
1 month	9.35	9.50	10.20
3 months	9.60	9.85	10.70
6 months	9.85	10.15	11.75
Eurodollar Deposits			
1 month	9.88	10.00	11.50
2 months	10.00	10.18	11.75
3 months	10.13	10.38	12.00
Commercial Paper - Prime Names			
Directly placed by:			
Finance Companies			
1 week	9.40	9.53	10.04
1 month	9.45	9.59	10.22
3 months	9.74	9.87	10.54
Bank Holding Companies			
1 month	9.19	9.19	10.22
Dealer Placed:			
3 months	9.70	9.71	9.87
New AA Corporate Utility Bond	12.90	13.00	14.30
Tax Exempt			
6 month Project Notes	5.60	5.65	5.25
1 year AAA Bond	6.00	5.70	6.75
5 year AAA Bond	7.10	7.00	8.00
20 year AAA Bond	9.30	9.30	10.00

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9/20/83

Financial Markets

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Economic Research &
Planning Division

Friday
(Noon)

Sept. 16, 1983

My last "Financial Markets" letter was a bit more prophetic than I might have hoped: We have had a great deal of market volatility. M1 fell by $2.0 billion last Friday, much more than the market had expected--bringing M1 to the bottom of its growth range--and so the bond market rallied sharply. Then, a rumor that this decline would be revised away stemmed the bond market rally, led the dollar to recoup its sharp losses in the foreign exchange markets, and sent the stock market down. Subsequently, the widespread conviction that today's (Sept. 16) money supply number will be up sharply has backed up bond yields much more. We indeed are experiencing much more volatility in the major financial markets: money, stock, and foreign exchange.

Whatever the Fed might say, these markets are very much looking at M1. The very notion that the stock market might decline on the basis of *rumors* of an M1 *revision* indicates the vulnerability and focus of that market. As for the bond and foreign exchange markets, these are plugged into the Fed's own reaction function. So far this year many analysts believe the Fed has been reacting more to M1's excessive growth spurts than to any other single factor. So can you blame the markets?

If there is something to blame, it's the Fed's resetting of a new M1 growth range at mid-year. While the FOMC realized that this new range might be misinterpreted by the market, the new range was adopted anyway. The market has chosen to watch M1's growth with a microscope only because the Fed has *consistently* seemed to react to it this year. Were the Fed to ignore M1, so would the markets. But the Fed has not, so the markets now see the possibility of M1 moving from the bottom to the top of its growth range (in one week!) and they have reacted accordingly.

Unfortunately for the markets, it appears that the Fed really has changed its emphasis. The economy seems to be at the center of the Fed's policy objectives even though money growth remains important. And the lesson of the past three years is that high interest rates don't stop this economy quickly. Indeed, very high interest rates are required. As a result the Fed will be looking at the most interest-sensitive sectors: housing and autos. Signs of true weakness here will lead the Fed to back off because it wishes the recovery to continue. The Fed *will* lower rates long before the economy posts declines in real income. Thus, it is this much more eclectic policy that puts M1's velocity in the limelight.

I do not contend that M1 growth is irrelevant and that market reactions are "wrong." Rather, M1 is important when its growth is clearly excessive: at the top, or over the top, of its growth range. In other circumstances the economy, or put differently, M1's velocity, is important. Thus M1 has an asymmetric importance. The markets clearly appreciate that, if M1 rises, interest rates will rise too. However, they seem not to grasp (yet) that a weaker growth of M1 will take some time before it will translate to a policy of easing by the Fed. So let's expect lower interest rates but let's not get overanxious.

Robert A. Brusca

Irving Trust

Market Yields

	9/16/83 (Noon)	Week Ago	Year Ago
Prime Lending Rate at Irving Trust Company	11.00%	11.00%	13.50%
Effective since	8/8/83		
Discount Rate at Federal Reserve Bank	8.50	8.50	10.00
Federal Funds	9.63	9.63	10.25
Repurchase Agreements	9.60	9.50	8.50
U.S. Treasury Issues			
Bills			
3 months	9.40	9.42	8.24
6 months	9.81	9.91	10.10
1 year	10.19	10.31	11.09
Coupons			
2 years	10.91	10.87	12.03
4 years	11.36	11.39	12.57
7 years	11.67	11.68	12.71
10 years	11.73	11.71	12.54
Long Bond	11.76	11.71	12.13
Negotiable Certificates of Deposit-Secondary Market			
1 month	9.40	9.40	10.55
3 months	9.50	9.50	10.95
6 months	9.75	9.80	11.70
1 year	10.35	10.25	12.00
Banker's Acceptances			
1 month	9.42	9.35	11.50
3 months	9.55	9.60	11.13
6 months	9.86	9.85	12.25
Eurodollar Deposits			
1 month	9.94	9.88	10.40
2 months	10.00	10.00	10.90
3 months	10.00	10.13	11.65
Commercial Paper - Prime Names			
Directly placed by:			
Finance Companies			
1 week	9.65	9.40	9.53
1 month	9.59	9.45	10.10
3 months	9.60	9.74	10.67
Bank Holding Companies			
1 month	9.19	9.19	10.62
Dealer Placed:			
3 months	9.73	9.70	10.67
New AA Corporate Utility Bond	13.00	12.90	14.45
Tax Exempt			
6 month Project Notes	5.65	5.60	5.40
1 year AAA Bond	5.50	6.00	6.75
5 year AAA Bond	6.70	7.10	8.00
20 year AAA Bond	9.35	9.30	10.10

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Financial Markets

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**Economic Research &
Planning Division**

Friday
(Noon)

Sept. 23, 1983

For a time this past week market participants became enthused--convinced that the Fed was easing its policies. Enthusiasm was triggered by the fact that in a five-day operating period the Fed executed or announced eight separate reserve-adding transactions: two large customer RPs, one outright purchase of securities, and five System RPs. These perhaps "too obvious" signals of "easing" by the Fed helped the market to rally through an auction period despite a $5.5 billion increase in the money stock reported the previous Friday. These reactions reflect but a partial and preliminary reading of the tea leaves. Indeed, these operations can easily be dismissed in terms of their significance as policy indicators.

By now most observers are aware that there is a good technical reason for the Fed to have done all these RPs. As tax receipts have come into the U.S. Treasury, and with quarter-end approaching, the government temporarily finds itself with excess cash balances. To some extent these balances are redeployed at commercial banks. However, the Treasury requires that banks collateralize these deposits with government securities to protect their value. Thus banks set a limit on the amount of these deposits they will accept. When the Treasury's balances exceed this amount, the excess spills over into the Treasury's Fed account, draining reserves from the banking system and requiring the Fed to offset this drain. Thus we get System RPs.

Even so, some analysts have taken the position that the Fed's oversupplying of reserves--evidenced by the low Fed funds rate--represents a tilt toward an easier Fed policy overall. But this conclusion attributes to the Fed too great an ability to fine tune the market. Moreover, if the Fed is purposely being more accommodative with reserves, this may not reflect policy as much as politics. In early August, during the last round of auctions, the Fed let the funds rate rise, and the auctions went poorly. Treasury Secretary Regan blamed the Fed for tightening. Mr. Volcker denied any significant change in policy had occurred relative to the course that had been embarked upon in late May. He continued to say that large government budget deficits were responsible for the market jitters and the poor auctions. The subsequent release of FOMC minutes and intermeeting telephone conferences did reveal that, in late July, a course of marginally more restrictive reserve availability (though not necessarily higher interest rates) had been agreed to. With this legacy from the last set of auctions the Fed may have decided to be somewhat easier on rates during the recent auctions, even without changing its policy.

The Fed's signals are going to be hard to read until we get through this end-of-quarter period with its technical factors. However, the continuing strength of the economy argues for continued firm rates. The weaker money growth gives the Fed some slack to lower rates. This explains why the market is encouraged and has moved more than the Fed has. While this is not necessarily inappropriate, we should not expect too much from the Fed too soon--the money stock has grown a great deal already this year.

Robert A. Brusca

Irving Trust

Market Yields

	9/23/83 (Noon)	Week Ago	Year Ago
Prime Lending Rate at Irving Trust Company	11.00%	11.00%	13.50%
Effective since	8/8/83		
Discount Rate at Federal Reserve Bank	8.50	8.50	10.00
Federal Funds	9.13	9.63	10.25
Repurchase Agreements	8.95	9.60	9.50
U.S. Treasury Issues			
Bills			
3 months	9.23	9.40	7.82
6 months	9.49	9.81	9.75
1 year	9.87	10.19	10.69
Coupons			
2 years	10.64	10.91	11.71
4 years	11.12	11.36	12.01
7 years	11.48	11.67	12.05
10 years	11.49	11.73	12.28
Long Bond	11.49	11.76	11.88
Negotiable Certificates of Deposit-Secondary Market			
1 month	9.25	9.40	10.10
3 months	9.25	9.50	10.75
6 months	9.40	9.75	11.20
1 year	9.80	10.35	11.65
Banker's Acceptances			
1 month	9.20	9.42	10.00
3 months	9.25	9.55	10.65
6 months	9.52	9.86	11.20
Eurodollar Deposits			
1 month	9.68	9.94	11.13
2 months	9.68	10.00	11.50
3 months	9.75	10.00	11.75
Commercial Paper - Prime Names			
Directly placed by:			
Finance Companies			
1 week	8.63	9.65	9.90
1 month	9.19	9.59	10.10
3 months	9.34	9.60	10.67
Bank Holding Companies			
1 month	8.94	9.19	9.84
Dealer Placed:			
3 months	9.54	9.73	9.74
New AA Corporate Utility Bond	12.55	13.00	14.00
Tax Exempt			
6 month Project Notes	5.40	5.65	5.20
1 year AAA Bond	5.50	5.50	6.00
5 year AAA Bond	6.75	6.70	7.50
20 year AAA Bond	9.00	9.35	9.75

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10/5/83 B4750-1

Financial Markets

Irving Trust

Irving Trust Company
One Wall Street
New York, NY 10015

**Economic Research &
Planning Division**

Friday
(Noon)

Sept. 30, 1983

The long-awaited quarter-end pressure on the Fed funds rate is finally developing --the result is confusion. It's not because the funds rate has moved so high, but because that rate had moved so low and now has returned up into, and above, its former trading range. Many observers have been confused by the fact that rates have been bouncing about so abruptly. However, the movement in rates is considered sharp only by recent standards, not by the standards of 1980 or 1981. Moreover, the reason the Fed allows rates to be this volatile is that the Fed is not pegging interest rates as it had in the period prior to October of 1979. Under the post-October 1979 procedures, technical factors and market expectations are allowed to play a larger role in the determination of the Fed funds rates. Still, these forces are more unsettling to the market in a period following great interest rate stability.

With the exception of last week, the average weekly Fed funds rate, since the statement week ended July 20, has resided in a range of 26 basis points: from 9.41% to 9.67%. Interestingly, the sharpest weekly movement in rates during this period was from 9.67% in the week ended August 17 to 9.41% in the week ended August 24. Now, just five weeks later, we see another abrupt move in rates: from 9.48% to 9.04%, again in consecutive weeks. What's going on here? Is the Fed suddenly easing?

The answer seems to be both no and yes. First, the Fed is not doing anything suddenly. It tends to act slowly and deliberately when the direction for policy is clear. However, the Fed does seem to have eased somewhat, simply because it has allowed rates to move down to lower levels and to stay there. However, evidence from reserve statistics is less able to support the contention of a Fed easing.

The evidence in the reserve factors is important because reserve availability is the primary tool the Fed uses to manipulate interest rates. It is important to note that the two recent downturns in rates were not accompanied by any clear or persistent Fed action with bank reserves. The first easing (Aug. 24) coincided with the financial markets' bullishness, which accompanied the unexpected downturn of M1 into its new monitoring range. The second easing (Sept. 28) was the result of a sharp buildup in Treasury cash balances, which the Fed strongly offset. The current rebound in rates at quarter-end makes the Fed's too-aggressive Treasury balance offset operations look like even more of an error than they were--but it also clarifies them as mostly technical. Indeed, the Fed has kept its net borrowed reserve figures broadly in the $250-$450 million region (on a three-week moving average basis) since July 20. Two recent weeks have slipped below that range, but they were weeks of firm Fed funds rates. The more important, but less noticed, six-day reserve figures (Thurs.-Tues.) have been even steadier since July 20, ranging from $450 to $620 million net borrowed reserves for the three-week moving averages. Here there is some indication of an easing by the Fed, but it's a very modest one. Most of the easing so far has been done by the market. We are still waiting for the Fed to make a real move.

Robert A. Brusca

Irving Trust

Market Yields

	9/30/83 (Noon)	Week Ago	Year Ago
Prime Lending Rate at Irving Trust Company	11.00%	11.00%	13.50%
Effective since	8/8/83		
Discount Rate at Federal Reserve Bank	8.50	8.50	10.00
Federal Funds	10.50	9.13	10.50
Repurchase Agreements	9.50	8.95	10.38
U.S. Treasury Issues			
Bills			
3 months	9.08	9.23	7.69
6 months	9.48	9.49	9.24
1 year	9.83	9.87	10.31
Coupons			
2 years	10.54	10.64	11.19
4 years	11.00	11.12	11.58
7 years	11.39	11.48	11.62
10 years	11.43	11.49	11.91
Long Bond	11.44	11.49	11.72
Negotiable Certificates of Deposit-Secondary Market			
1 month	9.10	9.25	10.10
3 months	9.15	9.25	10.38
6 months	9.40	9.40	10.65
1 year	9.90	9.80	11.00
Banker's Acceptances			
1 month	9.20	9.20	10.00
3 months	9.25	9.25	10.25
6 months	9.42	9.52	10.65
Eurodollar Deposits			
1 month	9.50	9.68	11.13
2 months	9.50	9.68	11.25
3 months	9.63	9.75	11.50
Commercial Paper - Prime Names			
Directly placed by:			
Finance Companies			
1 week	9.14	8.63	10.56
1 month	9.33	9.19	10.48
3 months	9.74	9.34	10.67
Bank Holding Companies			
1 month	8.81	8.94	10.10
Dealer Placed:			
3 months	9.42	9.54	10.40
New AA Corporate Utility Bond	12.55	12.55	13.75
Tax Exempt			
6 month Project Notes	5.30	5.40	5.20
1 year AAA Bond	5.25	5.50	6.50
5 year AAA Bond	6.70	6.75	7.50
20 year AAA Bond	8.90	9.00	9.80

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Financial Markets

Irving Trust

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**Economic Research &
Planning Division**

Friday
(Noon)

Oct. 7, 1983

The financial markets definitely have picked up the trend of lower U.S. interest rates. The short-term money markets, the long-term capital markets, and the equities market have all responded favorably. And--at long last--the dollar has moved lower and seems to be vulnerable on the foreign exchange markets. The "consensus" that U.S. rates are moving lower has come for only one perceptible reason: M1 has remained firmly within its new monitoring range since mid-August. However, with so many participants looking for lower rates, a number of justifications for a lower rate environment have been offered. But do these really carry weight?

Most of them really don't. They amount to mere after-the-fact justifications. For example, the most popular explanation for lower rates is the current LDC debt problem. Surely the U.S. must lower rates for this reason. In 1982 the debt problem was the prime concern of the Fed and (probably) the reason for a more lax monetary policy at that time. This year, right after the recent IMF meeting and before the FOMC met again, interest rates began moving down, and the dollar began to lose its steam. Surely this is no coincidence of timing, or so the claim goes.

I don't buy this argument for several reasons. First, in 1982 the debt crisis hit with full impact and came as quite a surprise because of the scope and depth of the problems that emerged. Concern over the systemic consequences of the crisis led the Fed to pursue a more moderate monetary policy than it otherwise would. Now, however, circumstances have changed. The debt problem is more mature, and in some ways worse, but it is being delegated to the appropriate specialists. While concern over the LDC problem still tempers the Fed's activities, I cannot believe that it is the prime factor in moving U.S. rates down a few basis points: A few ticks off the level of rates simply don't help the indebted that much. Moreover, the market's focus is on a few highly publicized events involving particular debtor nations. In these cases we must feel that the U.S. would do something specific to help an individual country rather than to alter the entire course of U.S. macroeconomic policy.

Some argue that rates must be lowered to promote economic recovery. Indeed, the main thrust of U.S. monetary policy is to promote recovery in the U.S.: This is an objective that serves both domestic and international purposes. This recovery continues to be on track and as vigorous as the average postwar recovery. There is no pressing need, however, to lower rates now to give this economy a shot in the arm. Indeed, the Fed does not seem to have moved rates that much: The reserve positions of the banking system vis-a-vis the Fed have swung widely in recent weeks with no clear trend toward ease. The market, however, has moved on the expectation that well-behaved money growth will continue, and this will keep rates from ratcheting up again soon. However, because the recovery is still well on track and because some of the inflation news is not so good, we should expect the Fed to remain stingy with further rate declines--even if the market presses for them.

Robert A. Brusca

Irving Trust

Market Yields

	10/7/83 (Noon)	Week Ago	Year Ago
Prime Lending Rate at Irving Trust Company	11.00%	11.00%	13.00%
Effective since	8/8/83		
Discount Rate at Federal Reserve Bank	8.50	8.50	10.00
Federal Funds	9.38	10.50	9.63
Repurchase Agreements	9.30	9.50	9.38
U.S. Treasury Issues			
Bills			
3 months	8.89	9.08	7.64
6 months	9.29	9.48	8.67
1 year	9.66	9.83	8.97
Coupons			
2 years	10.40	10.54	9.84
4 years	10.90	11.00	10.37
7 years	11.28	11.39	10.61
10 years	11.30	11.43	11.20
Long Bond	11.35	11.44	11.13
Negotiable Certificates of Deposit-Secondary Market			
1 month	9.05	9.10	9.60
3 months	9.15	9.15	9.70
6 months	9.30	9.40	9.60
1 year	9.80	9.90	9.80
Banker's Acceptances			
1 month	9.05	9.20	9.60
3 months	9.20	9.25	9.70
6 months	9.35	9.42	9.55
Eurodollar Deposits			
1 month	9.43	9.50	10.38
2 months	9.43	9.50	10.50
3 months	9.56	9.63	10.75
Commercial Paper - Prime Names			
Directly placed by:			
Finance Companies			
1 week	9.14	9.14	9.14
1 month	9.19	9.33	9.71
3 months	9.21	9.74	10.00
Bank Holding Companies			
1 month	8.81	8.81	9.71
Dealer Placed:			
3 months	9.24	9.42	9.21
New AA Corporate Utility Bond	12.50	12.55	13.00
Tax Exempt			
6 month Project Notes	5.20	5.30	4.75
1 year AAA Bond	5.25	5.25	5.10
5 year AAA Bond	6.70	6.70	7.00
20 year AAA Bond	8.90	8.90	9.00

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Financial Markets

Irving Trust

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New York, NY 10015

Economic Research &
Planning Division

Friday
(Noon)

Oct. 14, 1983

Release last Friday of the notes from the August 23 FOMC meeting cast a pall over the financial markets. As a result, when the money and capital markets reopened on Tuesday, rates rose across a broad spectrum of maturities. This market reaction was somewhat surprising in view of a survey of money market economists at major financial institutions that had revealed a general belief that the FOMC notes would indicate the Fed had not fundamentally altered its policies at the August meeting. So what was the bad news contained in the FOMC notes?

The news that seems to have had the strongest market impact is twofold, concerning both money supply and the economy. First, on money supply, the FOMC notes indicate that it was "apparently...(in) response to slower-than-expected growth in the money supply..." that interest rates fell off from their mid-August peaks. Subsequent discussion clarifies that the Fed itself did not change the pressure on bank reserve positions at the time that rates fell. On the economic front, the FOMC asserts that incoming economic data, particularly weak retail sales for June and July, contributed to the tailing off in rates. Furthermore, as the committee met, the economy was "continuing to expand quite rapidly." Prospects were for an..."economic recovery that would continue in the latter part of 1983 and in 1984, though at a more moderate pace..." Taken together these descriptions do not indicate a monetary authority on the verge of cutting rates. However, the FOMC report was not totally one-sided; it did contain some caveats about the possibility that recovery might not endure.

Looking at the Fed's interpretation of recent monetary data, the market likely became more displeased. The Fed's focus on money supply clearly referred to M2 and M3. Furthermore, the Fed indicated that some of the recent slowdown in the growth of these aggregates was probably of a technical nature and might be reversed. This would displease a market eager to rally because M1 has been looking weaker recently--indeed, at 4.6%, its June to September annual growth rate is way below the interim target of 7%. Instead, the Fed report referred to M1 almost in footnote fashion, giving M1 importance in its report only to the extent of saying the market had reacted to M1. (Reading between the lines, one reasonably concludes that this means overreacted to M1.)

Despite what economists may predict, market participants act on their own instincts. Therefore, despite all the above rationalization, we must remember that the FOMC report did dash the hopes of those who ignored the economists' analysis. Many market players simply could not believe that the coincidence of the August FOMC meeting and the simultaneous downturn in the effective Fed funds rate was not an overt policy move. Yet it wasn't. Now all eyes are on the Fed and, perhaps, less focused on M1. But don't be too disappointed that the August meeting didn't produce an easing in policy. While the Fed funds rate isn't at 9%, neither is it at 9 3/4%--where it seemed headed in mid-August. The Fed has clearly been less aggressive recently; it's stuck in a holding pattern.

Robert A. Brusca

Irving Trust

Market Yields

	10/14/83 (Noon)	Week Ago	Year Ago
Prime Lending Rate at Irving Trust Company	11.00%	11.00%	12.00%
Effective since	8/8/83		
Discount Rate at Federal Reserve Bank	8.50	8.50	9.50
Federal Funds	9.25	9.38	9.25
Repurchase Agreements	9.13	9.30	9.00
U.S. Treasury Issues			
Bills			
3 months	9.09	8.89	7.76
6 months	9.51	9.29	8.28
1 year	9.87	9.66	8.92
Coupons			
2 years	10.65	10.40	9.90
4 years	11.14	10.90	10.47
7 years	11.55	11.28	10.63
10 years	11.60	11.30	11.20
Long Bond	11.64	11.35	10.95
Negotiable Certificates of Deposit-Secondary Market			
1 month	9.15	9.05	9.15
3 months	9.20	9.15	9.25
6 months	9.40	9.30	9.45
1 year	9.80	9.80	9.60
Banker's Acceptances			
1 month	9.15	9.05	9.05
3 months	9.30	9.20	9.25
6 months	9.45	9.35	9.40
Eurodollar Deposits			
1 month	9.62	9.43	9.88
2 months	9.69	9.43	10.00
3 months	9.75	9.56	10.13
Commercial Paper - Prime Names			
Directly placed by:			
Finance Companies			
1 week	9.27	9.14	9.14
1 month	9.33	9.19	8.94
3 months	9.34	9.21	9.07
Bank Holding Companies			
1 month	9.19	8.81	8.04
Dealer Placed:			
3 months	9.36	9.24	9.21
New AA Corporate Utility Bond	12.65	12.50	12.50
Tax Exempt			
6 month Project Notes	5.35	5.20	4.25
1 year AAA Bond	5.75	5.25	5.25
5 year AAA Bond	7.00	6.70	6.40
20 year AAA Bond	9.60	8.90	8.40

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Economic Research &
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Friday
(Noon)

Oct. 21, 1983

Some of the well known bears of Wall Street have come out of their dens to sound a note of caution and to predict that rises in interest rates are inevitable as public and private credit demands clash. While this phenomenon, called crowding out, is a matter of some concern, I would direct that concern to a point further into the recovery. For now, I feel crowding out is not a problem. We should have almost another year before crowding-out effects become substantial enough to preclude the possibility of some modest rate declines from current levels.

The concept of crowding out has been popularized in recent years. It maintains that there is a queue for credit with the public sector always first in line. As public sector demands for credit grow--in the presence of unchanged private sector demands --they put pressure on interest rates, and this process causes private sector borrowers to cease to want to borrow at prevailing market rates. Businesses postpone the projects that would have been financed by their borrowings. Crowding out therefore results in a replacement of private sector expenditure with public sector expenditure in addition to its impact on interest rates.

There are two elements to the crowding out story: the public sector and the private sector. In this economic recovery, it is already widely conceded that the government's deficits will be massive over the foreseeable horizon--so much for the public sector. Then what about the private sector? Thus far, the private sector hasn't produced much of a strain. According to the widely cited flow of funds data, nonfinancial corporations have been running a large financial surplus. The largest private sector use of funds has been through the household sector's demand for mortgage financing. However, because of the mortgage-pooled securities, the banking sector needn't be the supplier of all these mortgage demands. Yet the banking sector is usually in the middle of the crowding out picture. Commercial banks, for example, will invest heavily in government securities when other credit demands are slack. In the first half of this year, they bought governments at nearly an $80 billion annual rate. As private credit demands pick up in the future--for inventory and investment--securities purchases by banks will decline, and eventually holdings of securities may be sold outright. This really reflects how crowding out works in practice. As banks take on the higher yielding private sector assets, the nonbank sector must absorb increasing amounts of U.S. Treasuries. If, initially, savings are not sufficient to support the increased credit demands, interest rates rise, leading to greater savings flows enabling investors to hold the now higher-yielding securities. This is a bit of an involved process. It does not happen overnight. Don't confuse crowding out with what happened in the aborted 1980 economic recovery. That was excessive money demands bumping against a restricted money supply. The process of crowding out will be slower, more subtle, and later in starting.

Robert A. Brusca

Irving Trust

Market Yields

	10/21/83 (Noon)	Week Ago	Year Ago
Prime Lending Rate at Irving Trust Company	11.00%	11.00%	12.00%
Effective since	8/8/83		
Discount Rate at Federal Reserve Bank	8.50	8.50	9.50
Federal Funds	9.31	9.25	9.38
Repurchase Agreements	9.25	9.13	9.25
U.S. Treasury Issues			
Bills			
3 months	8.82	9.09	7.86
6 months	9.23	9.51	8.47
1 year	9.64	9.87	9.02
Coupons			
2 years	10.50	10.65	9.87
4 years	10.98	11.14	10.49
7 years	11.39	11.55	10.68
10 years	11.45	11.60	11.18
Long Bond	11.51	11.64	10.96
Negotiable Certificates of Deposit-Secondary Market			
1 month	9.10	9.15	8.85
3 months	9.15	9.20	8.90
6 months	9.30	9.40	9.20
1 year	9.80	9.80	9.60
Banker's Acceptances			
1 month	9.10	9.15	8.75
3 months	9.21	9.30	8.90
6 months	9.31	9.45	9.25
Eurodollar Deposits			
1 month	9.50	9.62	9.50
2 months	9.56	9.69	9.63
3 months	9.63	9.75	9.75
Commercial Paper - Prime Names			
Directly placed by:			
Finance Companies			
1 week	9.14	9.27	8.63
1 month	9.19	9.33	8.56
3 months	9.21	9.34	8.54
Bank Holding Companies			
1 month	8.81	9.19	7.91
Dealer Placed:			
3 months	9.31	9.36	8.40
New AA Corporate Utility Bond	12.50	12.65	12.75
Tax Exempt			
6 month Project Notes	5.25	5.35	4.50
1 year AAA Bond	5.50	5.75	5.25
5 year AAA Bond	7.00	7.00	7.00
20 year AAA Bond	9.60	9.60	8.70

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